Bond University

DOCTORAL THESIS

Systemic and cyclical failure in Australian financial services and financial products sectors: have weaknesses in law contributed to these failures?

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SYSTEMIC AND CYCLICAL FAILURE IN AUSTRALIAN FINANCIAL SERVICES AND FINANCIAL PRODUCTS SECTORS: HAVE WEAKNESSES IN LAW CONTRIBUTED TO THESE FAILURES?

David Guy Millhouse

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Professor James Corkery, Professor Vai lo Lo, and Professor John Farrar

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ABSTRACT

This thesis proposes that there is systemic failure in financial services and financial product regulation in Australia. Australian law regulating and supervising Non-Bank Financial Entities (NBFEs) has failed those it purports to protect: the vulnerable investing public. Systemic failure manifests in extraordinary loss of investor funds: this thesis contains the sole holistic empirical analysis.

Australian regulation of financial products and financial services requires substantive strategic law reform. Without it, this thesis predicts systemic deficiencies in regulation will remain, repeating their cyclical manifestations. This study of Australian financial services and products regulation traverses four primary periods from 1981 to 2018. It explains the economic conditions which drove the development of the legal framework, traversing four discrete periods: 'Deregulation and Entrepreneurship' (1981–2001), 'Disquiet' (2002–2009), 'Reaction' (2010–2013) and the 'Age of Statutes' (2013 et seq.).

This thesis analyses judicial responses which demonstrate Australia has a long history of subsuming fiduciary principles in financial products and services provision, hiding behind statutory and contractual frameworks which facilitate grudging disclosure and creeping corruption.

Using doctrinal, empirical, qualitative, and comparative international legal analysis from five jurisdictions, this thesis demonstrates that comprehension of fiduciary principles is limited, applied haphazardly, often ignored, and subservient to statutory provisions which focus on compliance rather than investor value outcomes. Community expectations of what each market participant should do is often different from what they actually do. These ambiguities led investors to a false sense of security which was sadly and damagingly misplaced. There is a trust deficit.

The list of failures is long and often well known. What is less well known is the extraordinary loss of client and investor funds. Losses amount to some AUD52.25 billion from more than 1.915 million investors in 199 senior court cases and a substantial loss of economic productivity. Australia's plight is not unique but no other nation with a sophisticated economy now suffers comparatively. There is substantial systemic risk buried deeply in the governance of entities in the financial system. Remedying this risk will require substantive law reform to eliminate or ameliorate its causes.

There has been a plethora of law reform proposals in financial products and services regulation. Largely these reforms have been tactical, not meeting their objectives because of systemic and cyclical failure in the implementation of each element of Australia's market model (ie Disclosure,

Advice, and Financial Literacy). This thesis tests that proposition. There is limited commonality of view and only superficial questioning of the basic tenets upon which Australia's regulation of financial products and services is based. Blame is being attached to the basic policy framework whereas in fact it is policy implementation and enforcement that has allowed systemic failures to manifest.

Similarly, it appears likely that inattention to these systemic deficiencies renders the Australian compulsory superannuation system fraught with contingent risk. This empirical analysis has predictive veracity. As Commissioner Heydon noted: *History appears to be repeating itself.*

Australia has benefited from its Twin Peaks market based regulatory system and arguably has progressed toward the first objective of an entrepreneurial wealth creating society competing with its global peers in many asset classes. The second objective, being financial stability and risk mitigation, has for many people exposed to NBFEs, an abject disaster. The inherent tensions between entrepreneurship and investor risk, optimal investor outcomes balanced with compliance, are not of themselves contradictory in a market based system, but they rely upon defining objectives, eliminating conflicts of objectives and conflicts of interest, significantly enhanced behavioural standards of market participants, and the de-politicisation of the regulatory environment.

Accretive statutory change is not enough. Cyclical corruption rooted in cultural mores requires excision, not management. Excision requires surgery. These issues recur in every segment of the NBFE sector, plagued by egregious related party transactions, their inherent conflicts of interest, and propensity to deceptive and misleading conduct, dishonesty and fraud.

Any discussion of law reform needs to comprehend the two problematic themes of expecting accretive statutory change to address cultural deficiencies and the primacy of fiduciary principles. The first theme is better understood and implemented by reflecting on international practice in comparable jurisdictions. The second theme will require a national sustained education and enforcement campaign to inculcate NBFE industry participants with fiduciary concepts. Cultural change to inject and extend fiduciary obligations and principles is a generational task. Presently, to the extent fiduciary principles are understood at all, their comprehension is not widespread, applied haphazardly, often ignored, and subservient to adherence to specific statutory and contractual provisions which focus on statutory compliance rather than value outcomes, being a principle of trust law.

This thesis demonstrates that it is only the courts that have applied those principles in meeting community expectations and they will need to continue to do so despite multiple statutory interventions.

KEY WORDS

Non-banks, shadow banking, systemic risk, funds management, trustees, fiduciaries, superannuation, regulators, investors, governance, financial advice, financial products, managed investment schemes

DECLARATION BY AUTHOR

This thesis is submitted to Bond University in fulfilment of the requirements of Doctor of Philosophy (PhD).

This thesis represents my own original work towards this research degree and contains no material that has previously been submitted for a degree or diploma at this University or any other institution, except where due acknowledgement is made.

David Guy Millhouse

PREFACE

This author, a director of MillhouseIAG Limited, funded the acquisition of Tolhurst Funds Management and Tolhurst Capital from Tolhurst in November 2003. These companies were later renamed Astarra Funds Management and Astarra Capital, subsequently, well after the divestment of this investment and his resignation as director in 2005, Trio Capital. This divestment and resignation arose directly from written concerns about related party transactions, conflicts of interest, corporate governance, and the value of collateral, being a portfolio of unregulated US securities provided by the principals of the major Astarra shareholder to support the acquisition financing. The written response from the controlling directors to those concerns was unacceptable. The author has never been a director or officer of any entity named Trio or of the Astarra Strategic Fund and was not involved in any way with subsequent proceedings concerning Trio (*R v Shawn Richard* [2001] NSWSC Garling J).

In 2009–10, MillhouseIAG organised, at its own cost, the replacement of Trio as Responsible Entity of its unimpaired private equity fund (*Trio Capital Limited (Admin App) v ACT Superannuation Management Pty Ltd* [2010] NSWSC 941, with its replacement as corporate trustee of its two institutional funds in process.

The author was subsequently privately examined by representatives of ASIC and APRA, providing document sets to both regulators. ASIC requested three and received five fit and proper character references from senior professional individuals. After meeting and discussion with APRA representatives, the author discontinued his public intention to refer matters arising from his examination to the Federal Court and entered into an enforceable undertaking with APRA. This can be viewed at http://www.apra.gov.au/registers. APRA's Federal Court proceedings were dismissed on the 4th November 2013 with no order as to costs.

In 2018, the Commonwealth established the Hayne Royal Commission[1] and the Productivity Commission issued its draft report into competition in the Australian Financial System.[2] Considerable

[1] Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Commissioner Hayne).
[2] Australian Government Productivity Commission, *Competition in the Australian Financial System* (Draft Report, January 2018).

media attention has resulted. Both are germaine to this thesis. They are referred to in the chapters and in the Postscript.

RESEARCH OUTPUTS

Colloquium, 'International Investment Regulation: Challenges for Developing Countries', *Twin Peaks, the Ascent into Uncertainty, the regulation of financial services and financial products in Australia 1981-2016* (Faculty of Law, Bond University, 30 June 2017).

ETHICS DECLARATION

The research associated with this thesis received ethics approval from the Bond University Human Research Ethics Committee, Application Number 0000015615

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A highlight of writing this thesis has been my visits to the Bond University campus from which I always returned consumed with enthusiasm and the fortitude to complete the task at hand. In particular, the unswerving support of Professor James Corkery, Professor Vai lo Lo, and Professor John Farrar, ably assisted by Daniel Walker in the faculty library and Tonya Roberts in the general staff.

Dr Wolfgang Babeck kindly reviewed the writing on Germany in Chapter 5. Ms Sharmila Gunasingham in Singapore provided background on its statutory and regulatory constructs. Mr Alan Jessup kindly provided a copy of his book, *Managed Investment Schemes* and Mr Niall Coburn has been of great guidance in respect of how this thesis research may be disseminated for the benefit of potential stakeholders. I am also indebted to those persons, too numerous to list here, who participated in the qualitative research interviews in Brisbane, Sydney, and Melbourne and to members of the Brisbane Business Forum who have provided both moral support and professional input.

I am particularly appreciative of the assistance provided by Mr John Knox of Huntley Group, and to Mrs Michelle Knox for their considerable financial support enabling the researching and writing of this work, and for their constant assistance in Sydney. My long standing clients, Mr Yinon Trieger and Mrs Vanessa Trieger of Resitech Group and Mr Lenard Poulter of Lenards, both based in Brisbane, constantly inspire me to ensure Australia deals with its systemic problems and develops a vibrant SME capital market. Mr Adrian Gruzman kindly reviewed the Preface.

My family has been wonderful: in particular my thanks go to Celia and Alan Moxon and to Rikk Millhouse whose tolerance of living with a doctoral candidate surpasses what can reasonably be humanly expected. He kindly prepared the diagrams in the narrative. Mr Oliver Hobelt has always been at hand to solve the many IT issues that have arisen which always seem to require immediate resolution. Proof reading is a fine art and I thank Catherine Karcher for her sterling efforts.

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ACC	Australian Crime Commission
ACCC	Australian Competition and Consumer Commission
ADI	Approved Deposit-Taking Institution
AFA	Association of Financial Advisers (Aus)
AFPA	Australian Forest Products Association
AICD	Australian Institute of Company Directors
AIOPP	Association of Independent Financial Planners (Aus)
ALI	American Law Institute
AML/CFT	Anti-Money Laundering/Counter Terrorism Financing
AMSLA	Australian Master Securities Lending Agreement
APRA	Australian Prudential Regulation Authority
APRC	Australian Prudential Regulation Commission
AFSL	Australian Financial Services Licence
ARFP	Asian Region Funds Passport
ASC	Australian Securities Commission
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
ATO	Australian Taxation Office
AUD	Australian dollar
BaFIN	Federal Financial Services Authority (Germany)
BEAR	Banking Executive Accountability Regime (Aus)
BJR	Business Judgment Rule
CAD	Commercial Affairs Department, Singapore Police
CAMAC	Corporations and Markets Advisory Committee (Aus)
CCIV	Corporate Collective Investment Vehicles (Aus)
CDO	Collateralised Debt Obligations
CDS	Credit Default Swaps
CESR	Committee of European Securities Regulators
CFMEU	Construction, Forestry, Mining, Engineering Union (Au)
CFPB	Consumer Financial Protection Bureau (US)
CFPL	Commonwealth Bank Financial Planning
CFR	Council of Financial Regulators (Aus)
CFSC	Corporations and Financial Services Commission (US)
CIA	Central Intelligence Agency
CIS	Collective Investment Scheme

CL	Credit License (Aus)
CLERP	Corporate Law Economic Reform Program (Aus)
CMS	Capital Markets License (Singapore)
COAG	Council of Australian Governments
CPFB	Central Provident Fund Board (Singapore)
CPL	Centro Property Trust
C-REIT	Canadian Real Estate Investment Trust
CRA	Credit Rating Agency
CRC	Cooperative Research Centre (Aus)
CRM	Client Relationship Model (Canada)
CSA	Canadian Securities Administrators
CSIRO	Cth. Scientific & Industrial Research Organisation (Aus)
CSLRC	Companies and Securities Law Review Committee (Aus)
D-REIT	German Real Estate Investment Trust
DOL	Department of Labour (US)
EBSA	DOL Employee Benefits Securities Administration (US)
EC	European Commission or European Community
EEA	European Economic Area
EMSA	European Securities and Markets Authority
ESG	Environment, Social, & Governance (UN)
EU	European Union
EUFSB	European Financial Stability Board
ERISA	Employee Retirement Income Security Act (US)
FCA	Financial Conduct Authority (UK)
FCA	Federal Court (Aus)
FCAFC	Federal Court Full Court
FINRA	Financial Industry Regulatory Authority (US)
FSA	Financial Services Authority (UK)
FSAC	Financial Sector Advisory Council (Aus)
FSB	Financial Stability Board (EU)
FLF	Financial Literacy Foundation (Aus)
FoFA	Future of Financial Advice (Aus)
FPA	Financial Planning Association (Aus)
FSAP	EU Financial Services Action Plan
FSB	Financial Stability Board
FSC	Financial Services Council (Aus)
FSR	Financial Services Regime (Aus)
FWC	Fair Work Commission (Aus)

GFC	Global Financial Crisis
GCGC	German Corporate Governance Code
GOE	Government Owned Enterprise
HCA	High Court (Aus)
HM	Her Majesty's Government (UK)
HNWI	High Net Worth Individual
ICAC	Independent Commission Against Corruption (Aus)
IFAA	Independent Financial Advisers Association (Aus)
IIF	Industry Innovation Fund (Aus)
IIROC	Investment Industry Regulatory Org. (Can)
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
IRS	Internal Revenue Service (US)
ISC	Insurance and Superannuation Commission (Aus)
ISO	International Standards Organisation
LFMC	Licensed Fund Management Company (Singapore)
LLP	Limited Liability Partnership
MAD	Market Abuse Directive (EU)
MAS	Monetary Authority of Singapore
MD&A	Management Discussion & Analysis (US)
MFDA	Mutual Fund Dealers Association (Can)
MGA	Managing General Agencies (Can)
MIC	Managed Investment Company (Aus)
MiFID	Markets in Financial Instruments Directive (EU)
MiFIR	Markets in Financial Instruments Regulation (EU)
MIS	Managed Investment Scheme (Aus)
MIT	Massachusetts Institute of Technology
NBFE	Non-Bank Financial Entity
NBFI	Non-Bank Financial Institution
NCCP	National Consumer Credit Protection
NSWSC	New South Wales Supreme Court (Aus)
NSWSCA	New South Wales Supreme Court of Appeal (Aus)
NTA	Net Tangible Assets (For Aus RE)
OECD	Organisation for Economic Cooperation & Development
OSFI	Office of Superintendent of Financial Institutions (Can)
PBGC	Pension Benefit Guarantee Corporation (US)
PC	Productivity Commission (Aus)
PDF	Pooled Development Funds (Aus)

PDS	Product Disclosure Statement (Aus)
PRA	Prudential Regulation Authority (UK)
QCA	Queensland Court of Appeal (Aus)
QSC	Queensland Supreme Court (Aus)
R&D	Research and Development
RBA	Reserve Bank of Australia
RE	Responsible Entity (Aus)
RPT	Related Party Transaction
RFMC	Registered Fund Management Company (Singapore)
ROC	Registered Organisations Commission (Aus)
RSE	Registrable Superannuation Entity (Aus)
SASC	South Australia Supreme Court (Aus)
SEC	Securities and Exchange Commission (US)
SFA	Securities and Futures Act (Sing)
SGD	Singapore dollar
SIFMA	Securities Industry & Financial Markets Assoc. (US)
SLA	Securities Lending Agreement
SLE	Single Legal Entity (Aus)
SMSF	Self-Managed Superannuation Fund
SMR	Senior Management Regime (UK)
SME	Small and Medium Sized Enterprises
S-REIT	Singapore Real Estate Investment Trust
SRO	Self-Regulatory Organisation (Can)
TCA	Trust Companies Act (Sing)
TPR	The Pensions Regulator (UK)
UCITS	Undertakings for Collective Investments in Transferable Securities
UK	United Kingdom
UN	United Nations
US	United States
VSC	Victoria Supreme Court (Aus)
VSCA	Victoria Supreme Court of Appeal (Aus)
WASC	West Australia Supreme Court (Aus)
WASCA	West Australia Supreme Court of Appeal (Aus)
WEF	Workers Entitlement Fund

CHAPTER 1: W[H]ITHER AUSTRALIA?

Financial regulation and supervision at a cross-roads

1. INTRODUCTION

This is the story of modern Australia: why parts of the Australian economy struggle in a twenty first century globalised world. Australian industry is heavily dependent on non-bank financing: Non-Bank Financial Entities[1] have filled these financing gaps.

> [T]heir growth leads to a virtuous cycle through which countries benefit from broader access to financial services and a more competitive, diversified financial sector … offer[ing] individuals and small- and medium-scale enterprises a broader menu of financial services … creating jobs … promot[ing] competition by introducing new industries that challenge the services and capacities of banks …[2]

NBFEs have played an extremely important role in business, asset, and consumer finance, particularly for ventures with limited ability to access bank finance. NBFEs have funded ventures which would not otherwise have been funded, and have been considerable sources of employment: they are marginal sources of capital. This thesis analyses the impact of the NBFE sector on Australian investors and the legal reasons why NBFE failures are cyclical and deeply rooted in deficiencies in the law.

NBFEs include those entities providing financial advice and wealth management, bank controlled wealth management entities, non-bank financial products providers, collective investment schemes, investment managers, trustees, custodians, research houses, asset allocation consultants, securities brokers, securities platforms, hedge funds, insurance entities, finance companies, workers entitlement funds, and superannuation entities (public, industry, corporate, and self-managed super fund (SMSF)). Their main distinction is not being authorised deposit-taking institutions (ADIs), and apart from some superannuation entities, not being prudentially regulated. These attributes set NBFEs apart from mainstream commercial banking, although many banks participate in NBFE markets through related party structures becoming vertically integrated financial conglomerates. Non-banks have also become financial conglomerates but have not been subject to prudential regulation. Some have been private or publicly listed vertically integrated multi-function financial entities; some are multinational

[1] NBFEs, sometimes referred to as Non-Bank Financial Institutions or NBFIs (a narrower term), colloquially known as shadow banking, terminology commonly used in other jurisdictions.
[2] Jeffrey Carmichael and Michael Pomerleano, 'The development and regulation of Non-Bank Financial Institutions' (Report, World Bank, 2002) xi.

financial services and funds management conglomerates; some have been taken into public ownership given their local systemic importance. '[N]o unique classification of institutions provided is appropriate to all situations'.[3] Shadow banks may include some commercial activity within banks, being a 'broad definition that captures many forms of financial intermediation that are important for economic growth'.[4]

NBFEs are sometimes categorised as 'investment banks'. This, and 'investment banking', are ill-defined terms. As Tuch notes, they can include, in the same entity: securities advice to wholesale and retail clients, underwriting, corporate advice, securities trading, investment research, securities dealing, corporate finance, asset management, private equity, hedge funds and foreign exchange trading.[5]

> The influence of investment banks in the financial system and broader community is vast and their importance is increasing. The transactions on which they advise can have significant consequences for business competition and employment, often on an industry-wide or national basis.[6]

Some become financial conglomerates. 'Financial conglomerates span industry domestic boundaries and international boundaries'.[7] They also span regulatory jurisdictional boundaries.

> Modern financial intermediation processes add newer elements that do not always fit into the traditional silo based ways of … market based-regulations … or market-specific supervision. Reform approaches need to be more holistic.[8]

With limited exceptions, none of the entities categorised as conglomerates in the empirical analysis are ADIs. The exceptions are multi-function holding entities which have acquired or control an ADI (eg a building society, general insurer). ADI functions of banking conglomerates which control financial planning and wealth management entities are excluded from the analysis.

NBFEs, however categorised are socially important and underpin the operation of the modern economy in Australia and elsewhere. They are systemically important and 'may contribute to the

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[3] Ibid 5.
[4] Stijn Claessens and Laura Kodres, 'The Regulatory Responses to the Global Financial Crisis: Some uncomfortable questions' (Working Paper No 14/46, International Monetary Fund, March 2014) 19.
[5] Andrew Tuch, 'Investment Banks as Fiduciaries: Implications for Conflicts of Interest' (2005) *Melbourne University Law Review* 478, 486.
[6] Ibid 484.
[7] Jeffrey Carmichael, 'Regulatory lessons from the Crisis: A view from Down Under' (Presentation to OECD/ADBI Roundtable, February 2010); see also, Mohamed Ariff, John H Farrar and Ahmed M Khalid (eds), *Regulatory Failure and the GFC – An Australian Perspective* (Elgar Online, 2012) ch 12.
[8] Claessens and Kodres, above n 4, 4.

build-up of systemic risk and severity of financial crises'.[9] These risks have included runs on funds and contagion. Other authors agree: 'Systemic risks emerged, yet went undetected or not addressed for some time and then created great havoc'.[10] This author's empirical analysis illustrates the point. Tuch notes the 'social repercussions and its public dimensions'.[11]

This thesis shows that many NBFEs have been and are of the size and systemic importance that the regulatory distinctions between ADIs and non-ADIs, and between ex ante supervision and ex post market conduct, may be obsolete and should be reviewed. The Australian superannuation asset base is larger than that of its banking system and heavily exposed to other NBFEs.

1.1 The Law Matters

The law matters. 'The law can facilitate economic development and not simply coerce, regulate and control'.[12] This maxim is being lost in present day Australian NBFE regulation and needs to be recovered. It can also have the opposite result. There is 'a positive relationship between financial sector functions and economic growth'.[13] 'Law Matters' means a jurisprudence regime which allows investors to feel confident of expected economic outcomes, uncorrupted by the political milieu. Is this the case in Australia today where significant numbers and groups of investors lack confidence in financial entities and their regulators? '[T]he state should create the framework — the rules of the game for the economy'.[14]

> The general legal framework is arguably the single most important determinant of a sound NBFI[E] sector. Legislation underpinning the specific framework for NBFIs [E's] is the foundation of good regulation … There should be no ambiguity.[15]

> [C]ountries that lack a coherent policy framework and effective regulations, nonbank financial institutions [NBFEs] such as insurance, leasing and finance companies, and collective investment

[9] Elias Bengtsson, 'Fund Management and Systemic Risk – Lessons from the Global Financial Crisis' (2014) 23(2) *Financial Markets, Institutions and Instruments* 101.
[10] Claessens and Kodres, above n 4, 4.
[11] Tuch, above n 5, 505 citing Charles R Geisst, *Investment Banking the Financial System* (Prentice Hall Business Publishing, 1995) 1.
[12] Justice Michael Kirby, 'The company director: past, present, and future' (Speech delivered at the Australian Institute of Company Directors, Tasmanian Division, Hobart, 1998).
[13] Carmichael and Pomerleano, above n 2, 12, citing Ross Levine, Norman Loaya and Thorsten Beck, 'Financial Intermediation and Growth: Causality and Causes' (World Bank Development Research Group, 1999).
[14] Matthew Qvortrup, *Angela Merkel Europe's most influential leader* (Duckworth Overlook, 2017) 338.
[15] Carmichael and Pomerleano, above n 2, 198.

> vehicles, can exacerbate the fragility of the financial system. This fragility is often the result of a conscious effort to arbitrage and circumvent banking regulations.[16]

The Law Matters thesis 'constitutes the crucial bedrock' that underpins economies.[17] Empirical analysis proves that law matters in NBFE regulation, supervision and governance including the selective application and enforcement of present law.[18]

Policymakers should create a regulatory environment that provides a platform for diffuse securities ownership which may then deliver superior economic results. This underpins a modern economy.[19] Why should the law matter? To whom does the law matter?

> The essential insight underlying the 'law matters' thesis is that, in an unregulated environment, there is a real danger that a company's 'insiders' (controlling shareholders and senior executives) will cheat outside investors who own equity.[20]

Indeed, this empirical legal analysis of Australian NBFE related party transactions supports that insight. Expropriation of value also occurs by tunnelling,[21] being non-related party transactions, addressed extensively in Germany and the EU through codified civil law duties of care and loyalty. Egregious transfer of shareholder value is facilitated by the narrow interpretation of fiduciary duty and the limited universe to which it is applied in Australia.

The Law Matters thesis is not without its critics: 'the historical experience in the US and the UK [casts] doubt on whether law is as pivotal and the thesis implies'.[22] Its basic premise 'seems irrefutable, but how much it matters indeed, is a matter of much conjecture'.[23] In practice, the 'law is one of many influences that shape economic development … differences in the nature and effectiveness of a country's financial system depend on investor protection.'[24] But the law is not the

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[16] Ibid 19.
[17] Ibid 346.
[18] Evan Jones, 'CBA, ASIC and the political class: partners in crime', *Independent Australia*, 7 July 2014 <http://www.independentaustralia.net/.../cba-asic-and-the-political-class-partners-in-crime>.
[19] Brian R Cheffins, 'Corporate Law and ownership structure: A Darwinian Link?' (2002) 25(2) *University of New South Wales Law Journal* 346, 347, citing Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (Transaction, 1932).
[20] Brian R Cheffins, 'Law as Bedrock: The Foundations of an Economy Dominated by Widely Held Public Companies' (2003) 23(1) *Oxford Journal of Legal Studies* 1, 6.
[21] Li-Anne Elizabeth Woo, 'The Importance of the Law Matters Thesis' (2006) 3(4) *Corporate Ownership & Control* 219, 221, citing Simon Johnson, Rafael La Porta, Florencio Lopez-de-Salines and Andrei Shleifer, 'Tunnelling' (NBER Working Paper No 7523, 2000) 12.
[22] Cheffins, 'Law as Bedrock', above n 20.
[23] Woo, above n 21, 226.
[24] Ibid 220.

only factor.[25] To whom law matters and which law matters are identified in this thesis — options for its future development are proposed in Chapter 6.

1.2 Historical background.

The story of modern Australia is a history of law reform designed to promote economic development circumvented and corrupted by malfeasors using legal uncertainties and omissions to further their own interests. The accretive culture, fragmentation and complexity of Australian law leads to uncertainty, ambiguity, and enforcement deadweight costs for investor and regulators. If Australia wishes to pursue an agenda of increasing living standards based on agility and innovation, then law reform is an essential pre-condition.

Australia has considerable history of NBFEs (including NBFIs).[26] This analysis of corporate failures in these Australian financial services and financial products providers since 1981 reveals a long litany of prominent NBFEs which have failed, with severe consequences for investors, creditors and governments.

Traditional assumptions that private investors are rational, accessing and applying all disclosed information are false. More modern behavioural economics theory,[27] leads to different conclusions and different regulatory postures. Behavioural economics recognises that investor biases and irrationality, often on the same set of disclosed facts in 'complex situation-dependent ways',[28] lead to different behaviours and decisions. This need not, nor should it as some suggest, provide an excuse for further government intervention. It does emphasise a community need for financial literacy competencies and a regulatory posture that treats investors as financial consumers learning from their financial advisers who tutor them in teachable moments. These insights have been implemented in Canada and Germany.

Australia is a global outlier in many important aspects of its NBFE regulation, although not alone in its original Twin Peaks architecture. It does not follow international standards and practice. Specifically, it is almost unique in the use of trusts as large commercial trading enterprises, low licencing and capitalisation barriers to entry, limited fit and proper competency requirements, non-

[25] Katharina Pistor, 'Rethinking the "Law and Finance" Paradigm' (2009) *Brigham Young University Law Review* 1647, 1669.
[26] Above n 1.
[27] See, eg, the work of Richard H Thaler, Robert J Shiller, and Xavier Gabaix; R Thaler and C Sunstein, *Nudge: Improving Decisions about Health, Wealth and Happiness* (Yale University Press, 2008) 7.
[28] Noah Smith, 'Wanted: A Unifying Theory of Behavioural Economics' (6 January 2018) <https://www.bloombergquint.com/onweb/2018/01/05>.

adherence to many International Organization of Securities Commissions (IOSCO) and Markets in Financial Instruments Directive (MiFID) 1 & 11 provisions, regulation of custody, and its poacher-gamekeeper model for collective investment schemes (Managed Investment Schemes or MIS).

Its corporate governance regime has often failed those it purports to protect: the investing public. Failure is not rare. Remediation is costly, of limited financial veracity, with significant time elapsed to achieve limited results. Systemic and cyclical failures are found in the implementation of each element of the Wallis[29] market model reforms (ie disclosure, advice, and financial literacy) of 1997 and the *Managed Investments Act* of 1998. This thesis tests that proposition since there is limited commonality of view[30] and public questioning of some of the basic tenets upon which Australia's regulation of financial products and services is based. Market conduct regulation largely deals with problems after the event: unlike prudential supervision it doesn't prevent them (not always successfully). Blame is being attached to the basic policy framework. But it is incomplete policy implementation and poor governance that has allowed systemic problems to manifest themselves, partly hidden until the GFC. This unveiling 'inspired a tornado of excoriating criticism of financial markets and their participants'.[31] Corporate governance is the implementive cousin of market conduct regulation: prudential supervision is its sibling, accompanied by familial moral hazard.

This research identifies more than 1 915 608 investors in Australia who have been financially damaged by corporate failures in NBFEs. Direct aggregate reported negative financial impacts are estimated to be at least AUD52.25 billion. This represents c 0.46% of 2016 – 17 nominal GDP. Consistently, EU law reform of retail investor capital markets was estimated to increase EU GDP by 'between 0.5 and 0.7% [pa].'[32] More importantly, it implies a foregone GDP growth rate of c 23.14% p.a. assuming GDP represents all Australian economic activity. The essential insight is that the cumulative misallocation of capital in aggregate — the opportunity cost — causes lower economic growth. This is particularly so because NBFE financing is at the margin — it finances projects that would not otherwise occur.

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29 S Wallis, *Australian Financial System Inquiry Final Report* (Australian Government Publishing Service, March 1997) ['Wallis'].
30 Kevin Davis, 'Study of Financial System Guarantees' (Australia Treasury, 2004) ch 2.
31 M Scott Donald, 'Regulating for fiduciary qualities of conduct' (2013) 7(2) *Journal of Equity* 142.
32 Friedrich Heinemann and Mathias Jopp, 'The benefits of a Working European Retail Market for Financial Services: Report to European Financial Services Round Table' (Institute für Europäische Politik, Berlin, 2002); See especially, Niamh Moloney, 'Building a Retail Investment Culture through Law: The 2004 Markets in Financial Instruments Directive' (2005) 6 *European Business Organisation Law Review* 354 citing ZEW/IEP, 'The Benefits of a Working European Retail Market for Financial Services' (Report, European Financial Services Round Table, 2002).

This data does not include consequential financial losses or other personal consequences. These losses are not aberrations. The Australian Securities and Investments Commission (ASIC) estimate that c AUD66.00 billion has been lost by investors in GFC related collapses from 2007-9.[33] These losses include entities that are not NBFEs. It can be misleading to blame the GFC for failures which should properly be attributed to other causes. The GFC merely exposed underlying systemic weaknesses. For instance, ASIC also estimate that c AUD20.00 billion of retail investment funds in NBFEs were 'frozen',[34] some never to be recovered. Chapter 3 of this thesis contains the only other authoritative empirical data.

Despite scholarly observations of 'reasonable expectations' in 2005[35] and some tactical regulatory change, very little has been implemented that would prevent another major collapse or scandal involving a NBFE. Failure has been and will be cyclical. These failures arise from a number of systemic causes. These include: flawed business models; related party transactions and conflicts of interest; poor investor outcomes arising from conflicts of economic objectives through tunnelling; complete loss through legally compliant financial products and procedures; deceptive and misleading conduct; fraud; and under capitalisation. These manifestations of systemic failure arise from uncertainties in the law, practical impediments to its application, lack of harmonisation between sources of law, and lack of investment economic objectives being an integral part of the body of law in superannuation and non-superannuation environments. These factors lead to arbitrage opportunities for those inclined to mal-, mis-, or non-feasance.

Australians (compulsorily) invest in an environment of a multitude of complex financial products (direct, corporate and superannuation) but are not afforded the protections they assume are there. It also appears likely that inattention to systemic deficiencies renders the Australian superannuation system fraught with contingent risk.

Subsequent regulatory response has been directly related to the degree of public pressure from those aggrieved seeking remedies as a result of a crisis, or a report driven by economic policy objectives. Many of the responses have been lacking insight and are mostly tactical.[36] However, these are not

[33] Tony D'Aloisio, 'Responding to the global financial crisis: the ASIC Story' (Speech delivered at the Trans-Tasman Business Circle, 30 November 2010).
[34] Ibid.
[35] Tuch, above n 5, 478, 482 citing Paul Finn, 'Contract and the Fiduciary Principal' (1989) 12 *University of New South Wales Law Journal* 76, 84.
[36] Chief Justice Paul de Jersey, 'Developments in Financial Services Law of the last 30 years' (Speech delivered at the Banking and Finance Services Law Association 30th Annual Conference, Gold Coast QLD, Australia, 30 August 2013).

new issues: 'the events of the late 1980s and early 1990s portrayed a failure of law, policy, and ethics'.[37] In the US, the law attempts to encourage entrepreneurship, the theory being that an entrepreneurial economy makes for a richer and more productive society. The law provides the architecture and it can mitigate investor risk. Since NBFEs are derivative exposures of the underlying real economy, the law of itself cannot prevent the underlying attrition of those market linked assets. However, for superannuation entities, Australian law now provides that directors and trustees must take into account market and longevity risks.

Shifting policy sands, constantly changing regulation, regular judicial review, and subsequent statutory responses make it extraordinarily difficult for a non-professional director, a director of a corporate trustee, or a trustee in person, to either understand the law or to properly discharge their duties. The present difficulty for regulatory reform in Australia is vested interest with differing objectives influencing a volatile political milieu.

Judicial review has led the way in the development and enforcement of present law, noting the need for statutory reform. Judicial opinion has been scathing about the deficiencies and uncertainties in the law regulating Australian financial products and financial services.[38] Other legal opinion is equally severe: 'overly prescriptive, complex and poorly drafted [PDS]: The regime relies upon definitions within definitions and exceptions within exceptions. It is difficult for lawyers to get their heads around – let alone investors lacking in legal training'.[39]

Australian law has been demonstrably deficient, especially compared with some comparative jurisdictions such as Canada, Germany and Singapore. Australian investors, other participants in the investment chain, and the broader economy have suffered as a result. Statutory reforms alone, whilst

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[37] Kirby, above n 12.

[38] See, eg, *Rich v Australian Securities and Investments Commission* [2004] HCA 42 [122] (Kirby J); *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 Summary 3 (Rares J); *Australian Securities and Investments Commission v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liquidation)(Controllers appointed)(No 3)* [2013] FCA 1342 (12 December 2013) [463] (Murphy J); *Re Environvest Ltd (No 4)* [2010] VSC 549 [2]–[3] (Judd J); *Aequitas v AEFC* [2001] NSWSC 14 [363] (Austin J); *Australian Softwood Forests Pty Ltd v Attorney-General (NSW); Ex Rel Corporate Affairs Commission* [1981] HCA 49 [37] (Murphy J); *Australian Securities and Investments Commission v Bridgecorp Finance Ltd* [2006] NSWSC 836 [17] (Barrett J) citing *Australian Securities and Investments Commission v Mauer-Swiss Securities Ltd* [2002] NSWSC 684 (Palmer J); *Trilogy Funds Management Limited v Sullivan (No 2)* [2015] FCA 1452 [1] (Wigney J); *ASIC v Vines* [2006] NSWSC 738 [14] (Austin J).

[39] Garry T Bigmore and Simon Rubenstein, 'Rights of Investors in Failed or Insolvent Managed Investment Schemes' in Stewart J Maiden (ed), *Insolvent Investments* (LexisNexis Butterworths, 2015) 238.

superficially attractive given the relative ease of implementation, have not and will not resolve systemic deficiencies in regulation nor their cyclical manifestations.

1.3 Creeping corruption in Australian NBFEs

Uncertainties in the law and inconsistences in its application have led to systemic creeping corruption in some financial services and financial products NBFEs. This has resulted in investor disbelief and in some cases, significant judicial interventions. Creeping corruption, sometimes arising from grudging disclosure, aided by uncertain and complex law, poor advice and unknowledgeable investors is systemic in the Australian NBFE sector. '[C]omplex legislation may mean that for those who deliberately seek not to comply with the law, they can readily do this…'.[40] This has not been restricted to Australia: in the UK, such sentiments are expressed as creative compliance and regulatory arbitrage. UK legislative recognition of the economic importance of Small and medium-sized enterprises (SMEs) was a driver of statutory reform[41] to meet the 'reasonable expectations of business people so that regulatory traps for the unwary are avoided'.[42] Directors, particularly of private companies were considered not to be able to understand their duties.

In Australia creative compliance or creeping corruption occurs where statutory provisions are interpreted narrowly and corruption escapes close scrutiny. In the longer term, this subverts the economic interests of investors and beneficiaries. The economic interests of investors and beneficiaries supported by holistic fiduciary standards in the investment chain is a different proposition from compliance with regulation. It leads to a different result:

> It [Creative Compliance] is essentially the practice of using the letter of the law to defeat its spirit, and to do so with impunity.[43]

Australian regulation of financial products and financial services requires substantive law reform and reforms designed to enhance productivity in the economy. Without substantive reform, there will be no remedy of the systemic deficiencies in regulation nor of their cyclical manifestations which harm productivity.

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[40] Hui Xian Chia and Ian Ramsay, 'Section 1322 as a response to the complexity of the Corporations Act 2001 (Cth)' (2015) 33 *Companies & Securities Law Journal* 389, 394.
[41] *Companies Act 2006* (UK).
[42] John Lowry, 'Codifying the corporate opportunity doctrine: The (UK) Companies Act 2006' (2012) 5 *International Review of Law* 1, 3.
[43] Simon Ashby, 'The Turner Review on the Global Banking Crisis: A Response from the Financial Services Forum' (Nottingham University, 2009) 17.

> Regulation can influence the growth of NBFIs [-Es] in two main ways: (a) repressive regulation can retard NBFI growth, and (b) inappropriate regulation or poorly designed regulatory structures can stimulate NBFI[-E] growth for the wrong reasons, often creating incentives for regulatory arbitrage and the emergence of unanticipated systemic problems.[44]

Australian law permits the contracting out of fiduciary obligations. In retail financial advice, the *Corporations Act* subsumes general law fiduciary obligation beneath regulatory process, the result being a mismatch of community fiduciary expectation with industry practice. In superannuation, statutory intervention excludes access to the 'general law relating to conflict of interest'.[45] Consequently, significant numbers of investors in Australia today have lost their trust in the financial system. Community expectations of, and trust in what each market participant should do is often different from what they actually do. These ambiguities have led investors to a false sense of security which was sadly and damagingly misplaced. Whilst Australia has benefited from its Twin Peaks market based regulatory system (posited by this author to be 'Triple Peaks', given the integral role of the industrial system in superannuation savings),[46] and has arguably progressed toward the first objective of an entrepreneurial wealth creating society competing with its global peers in many asset classes, the second objective, being financial stability and risk mitigation, has for many people been an abject disaster.

This thesis quantifies their direct losses and analyses the economic consequences to the nation. Its empirical analysis demonstrates that failure is predictable, cyclical, and has deep legal systemic roots.[47] The empirical data points to failures of law on a massive scale. It also points to legal solutions to the problem of anti-entrepreneurial repressive legislation (accretive statute) and to solutions to unanticipated systemic failures particularly of vertically integrated NBFEs in a consolidating market. These solutions can also be applied to NBFE entities associated with commercial banks.

There has been no quantitative assessment of the costs to the economy of legal complexity and uncertainty. These costs include compliance, director and trustee insurance, limited mutual recognition through lack of harmonisation, reduced capital inflows, reduced real economy investment, and reform fatigue.[48] Some might argue reform solutions will reduce the entrepreneurial capacity of the Australian economy. The contrary is the case. Restore the trust and the economy will respond. The economic losses directly incurred directly by investors and beneficiaries, added to

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[44] Carmichael and Pomerleano, above n 2, 208.
[45] *Superannuation Industry (Supervision) Act 1993* (Cth) s 58B.
[46] See fig 1.1.
[47] See below ch 3, tab 3.25.
[48] Chia and Ramsay, above n 40, 403.

foregone investment that may have taken place, has resulted in Australia having an economy reliant less upon domestic savings and more upon foreign capital to finance new business investment. The reform objective must be to re-establish trust, confidence and respect, which has been lost in several decades of often anonymous or poorly-informed financial product selling to vulnerable retail investors, despite repeated analysis and with similar conclusions from 2001.[49]

Reform requires significant elapsed time, probably a decade, and it must be sequenced. Strategic reform requires acceptance and implementation by the various stakeholder groups. Tactical reforms can be imposed legislatively. The effectiveness and stability generated by prudential supervision needs to be embedded as a governance value system – a culture – within the non-prudentially regulated NBFE sector. Successful implementation aligns interest of provider and consumer: it also changes the role of the regulators: they become educators, supervisors. A healthy culture results in enforcement becoming a last resort.

The inherent tensions are entrepreneurship versus investor risk; compliance versus optimal investor outcomes; legal rights versus economic interest, conflicts of interest and objectives, ex ante supervision versus ex post market conduct regulation, and the implementive power of sound corporate governance. That these tensions need not be contradictory is lost in the politicisation of the debate.

1.4 Reform implementation objectives

The neo-classical market model as envisaged by Campbell[50] and Wallis sought to create a regulatory environment that led to investment opportunities that did not exist previously and may not otherwise have existed at all. Given the societal need for a sound NBFE sector, these market freedoms were not matched by effective implementation of the strategic underpinnings of Wallis, being disclosure, advice, and investor empowerment and knowledge through education, nor in many cases, corporate governance responsibility and ethical standards.

Australia has not been alone in seeking to implement reform of its financial sectors. There are and will be contested reform agendas. These include the tension between investor empowerment and libertarian paternalism.[51] Their resolution will depend on acceptance of the reasons for failure.

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[49] Lord Myners, United Kingdom HM Treasury, *Institutional Investment in the UK: A Review* (March 2001).
[50] Sir Keith Campbell, *Committee of Inquiry into the Australian Financial System* (Australian Government Publishing Service, Cat No 8104251, Canberra, 1981) ['Campbell'].
[51] Jeremy Cooper, *Review of the Governance, Efficiency, Structure, and operation of Australia's Superannuation System* (Commonwealth of Australia, 30 June 2010) ['Cooper'].

International precedent provides a framework, offering three options.[52] Were the Wallis and other Australian market reforms faulty, or was their implementation faulty (if only because of political constraints)? Were there sequencing issues, or a simplification of the links between desired economic outcome and legal reform? Were the reforms incomplete?

Analysis, in a different but comparable context,[53] 'blames the poor post-reform outcomes on uneven and incomplete reform implementation'.[54] Political interest generates contested reform implementation in Australia. Similarly, in the US, trade protectionism since 2016 challenges the Washington Consensus and is inconsistent with delayed reform and statutory repeal in its financial services markets, or indeed the rollback of previous reform.[55] Whatever the architecture, political constraints to reform implementation come at a price to the financial consumer.

1.5 Four distinctive periods

The history of the development of the law of the Australian financial services and products regulatory sector would be incomplete without an understanding of the economic conditions which drove the development of the legal framework. This framework can be divided into four primary periods: The Age of Entrepreneurship and Deregulation (1981-2001), The Age of Disquiet (2002-2009), The Age of Reaction (2010-2013) and the Age of Statutes and Compliance (2014 et seq). It illustrates the tension between market based principles of Australian financial system regulation and those that oppose or seek to modify a market based approach.

The historical background 1981-2018 is found in Chapter 2. The works cited include most of the inquiries and reviews of the period. Each of these works has influenced the law and regulation of NBFEs. They are largely tactical responses to crisis, not a repair of the systemic problems underlying regulatory failure in Australia. Chapter 3 quantifies the losses suffered by investors and beneficiaries and their broader economic impact. The empirical analysis has predictive veracity in identifying

[52] Nancy Birdsall, Augustus de la Torre and Felipe Valencia Caidedo, *The Washington Consensus — Assessing a Damaged Brand* (The World Bank Policy Research Working Paper, 5316, May 2010) 21.
[53] The Washington Consensus is a package of economic policy objectives, including deregulation of financial sectors, designed to promote economic development in emerging economies. See especially John Williamson, 'A Short History of the Washington Consensus' (Paper presented at the conference 'From the Washington Consensus towards a new Global Governance', Barcelona, 24–25 September 2004).
[54] Birdsall, de la Torre and Caidedo, above n 52, 22 citing Agnes A Belaisch et al, *Stabilisation and Reform in Latin America; A Macroeconomic Perspective of the Experience Since the 1990s* (International Monetary Fund, Occasional Papers No 238, 2005). See also Anne O Krueger, 'Meant Well, Tried Little, Failed Much: policy Reforms in Emerging Market Economies' (Speech delivered to the Economic Honours Society, New York University, New York, 23 March 2004).
[55] See, eg, Nicolas J Firzli, 'Understanding Trumponomics' (26 January 2017), Revue Analyse Financière <http://analysefinanciere.org/2017/01/26/understanding-trumponomics/>.

likely lawless behaviours. Chapter 4 analyses the judicial response and the resulting evolution of directors and trustee duties. Chapter 5 provides insights into comparative jurisdictions – Singapore, Germany (and EU), UK, Canada and the US. Chapter 6 proposes four strategic reform themes supported by tactical interventions. These themes suggest ways to resolve the legal reasons for systemic failure.

2. THE RESEARCH QUESTIONS

Understanding how Australia has arrived at this point in its regulation of financial services and financial products provides the research basis for determining which analytical methodologies to apply in the quest for solutions to a national problem. It requires analytical proof that systemic failures and cyclical manifestations continue to exist.

Is Australia unique? Or is it an outlier on the international stage, particularly in respect of comparative jurisdictions? Can this affect capital flows and investment? Do the experiences of other jurisdictions where there has been systemic failure provide guidance for Australian law? Are there recurring threads across common law jurisdictions? Do civil law jurisdictions provide insight?

What of the relationship between modern statutes and equity? How does increasing scale and scope of statutory interventions affect traditional fiduciary concepts of trust and loyalty, standards which are embedded in community expectation? How important is judicial intervention in meeting that expectation, and is it required in the future?

Do these questions manifest in uncertainty and weakness in Australian law? Do they provide opportunities for malfeasors? If so, what are those weaknesses and how can they be remedied? How can contagion between sectors of the financial economy be prevented by law reform?

What legal solutions are there to hypothesised systemic and cyclical failure? If proven, how can law reform be implemented in a contested intellectual and political environment? What are the objectives of proposed law reform and what is the pathway to resolution on a national scale?

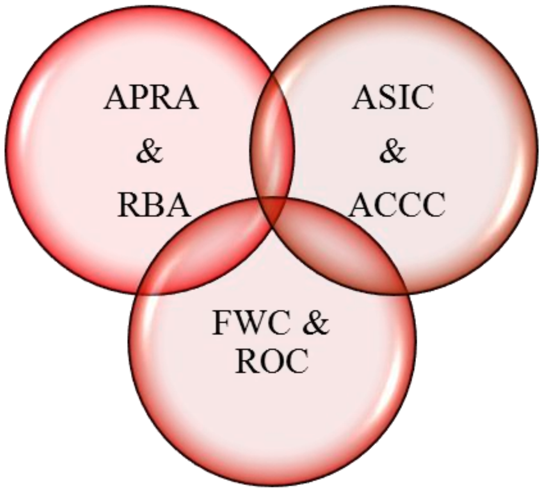
3. STATUTORY FRAMEWORK

Relevant law includes a number of Australian statutes and their interaction with the general law. The primary legislative instruments which seek to regulate director, officer, and trustee responsibility for the governance of NBFEs are the *Corporations Act*,[56] *Superannuation Industry (Supervision) Act*,[57] and the *Fair Work (Registered Organisations) Amendment Act*.[58] The three primary regulators are subject to their own legislation: *ASIC Act*[59] (market conduct), *APRA Act*[60] (prudential supervision), and *Fair Work Act*[61] (the link between Australia's industrial and superannuation systems). As Murray[62] and Heydon[63] demonstrate, this interface is largely unexplored territory which may expose Australian superannuation to substantial contingent risk since it directly influences and determines corporate governance practices. Other relevant legislation includes the *Anti-Money Laundering and Counter Terrorism Financing Act*,[64] *The Public Interest Disclosure Act*,[65] and the *Competition and Consumer Act.*[66] In addition, there are sectoral governance rules and standards.[67]

[56] *Corporations Act 2001* (Cth).
[57] *Superannuation Industry (Supervision) Act 1993* (Cth).
[58] *Fair Work (Registered Organisations) Amendment Act 2016* (Cth).
[59] *Australian Securities and Investments Commission Act 2001* (Cth).
[60] *Australian Prudential Regulatory Authority Act 1998* (Cth).
[61] *Fair Work Act 2009* (Cth).
[62] David Murray, *Financial System Final Report* (Australia Treasury, 2014) ['Murray'].
[63] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report* (December 2015) (Commissioner Heydon).
[64] *Anti-Money Laundering and Counter Terrorism Financing Act 2006* (Cth).
[65] *The Public Interest Disclosure Act 2013* (Cth.)
[66] *Competition and Consumer Act 2010* (Cth).
[67] John Farrar and Pamela Hanrahan, *Corporate Governance* (Reed International – LexisNexis Butterworths, 1st ed, 2017) [30.2].

FIGURE 1.1 AUSTRALIA'S TRIPLE PEAKS NBFE REGULATORY ARCHITECTURE

- **Prudential supervision of ADI's, insurance & superannuation**
- **Financial system stability**
- **Monetary policy**



- **Market conduct regulation of ≥ 2.0 million entities**
- **Competition policy**

- **Registered organisation regulation**
- **Interface between industry, compulsory superannuation & financial systems**

4. METHODOLOGY

This thesis tests theories and practices of regulation, supervision, and governance applying traditional doctrinal legal analysis balanced with other research methodologies. These include empirical analysis, qualitative field research, and comparative law. Specifically, empirical analysis of senior court judgments supported by qualitative, interview based, original research tests the conclusions of doctrinal analysis. That is, set in both historical and thematic constructs. It demonstrates how Australia has themes of deregulation to facilitate entrepreneurship competing with accretive statute based compliance. The conclusions from this combination of research methodologies are then tested against the comparative law of other jurisdictions, being Canada, US, UK, Germany (and EU) and Singapore. These jurisdictions, despite differing legal traditions (civil and common law, statute and trust law) and their modern interpretations have sufficient commonality to provide insightful points of reference. Whilst Australia and Canada stem from the same legal family, their approach to solutions of similar legal problems can be quite different. Similarly for Singapore. This comparative law provides solutions to the issues identified from doctrinal and empirical research as being problematic in Australia. It draws upon the experiences of those comparative jurisdictions in the relationship between social sciences research in behavioural economics and traditional law.

The empirical analysis of content of senior court judgments and other primary sources demonstrates the workings of present law as it is: it proves the gap between community expectation and legal reality particularly as espoused in statutes. '[I]n Australia, comprehensive case data regarding filed cases or settled cases are not available'.[68] This empirical analysis is of published senior court judgments[69] of NBFE cases (n=320, of which 199 have authoritative primary data) 1981–2018. There is no electronic search system which captures the reasons for these senior court judgments and reliance on case catchwords can be misleading. These hand-collected data from the content of the judgments are supplemented by data sourced from other authoritative sources. This empirical research can be replicated by other legal scholars provided their coding of data and the necessary use of inference are consistent in their identification of outcome patterns.

These multiple research methodologies eliminate subjectivity and opinion: the outcomes are objective and evidence based, each methodology tested against the others. This combination of methodologies allows the development of four thematic reform objectives supported by tactical interventions, each

[68] Jenifer Varzaly, 'The Enforcement of Directors Duties in Australia: An Empirical Analysis' (2015) 16 *European Business Organisation Law Review* 281, 300.
[69] HCA, FCAFC, FCA, NSWSC, NSWCA, VSC, VSCA, QSC, QCA, SASC, SASCA, WASC, WASCA.

of which will require additional research in their implementation. These themes provide strategic clarity for future law reform reducing the risk of it being subsumed by pettiness, politicisation, and vested interests.

5. PREPARING FOR THE FUTURE

Australian law and regulation of financial products and services has largely developed in response to crises and public policy imperatives.[70] These

> [c]rises are more likely to reveal critical features of a complex system that remains undetected in the normal state. The purpose of a crisis analysis is not primarily to understand the cause of a specific corporate governance failure, but to learn about the system in which this failure occurred.[71]

There has been significant judicial review and intervention throughout this period followed by legislative reform of statutes. The 'institutional autops[ies]'[72] of major cases have steadily, if haphazardly, focussed and enhanced the duties of directors and trustees with a plethora of judicial interventions over this period in response to the cyclical nature of the underlying systemic problems unearthed. In Australia,

> [t]he law regulating managed investment schemes (and other commercial trusts) remains seriously inadequate, a situation that should be regarded as intolerable in respect of entities that are permitted to raise funds from the public … Australian trust law … suffers fundamental structural weaknesses as a system for regulating large and complex enterprise entities.[73]

Reform needs: 'a system-wide perspective explicitly aimed at addressing market failures; understanding and incorporating into regulations agents' incentives so as to align them better with societies' goals…'[74] and resisting ' fine tuning regulations'.[75] 'The sad news is that the general approach to reforms [ha]s largely still been based on an outmoded and by now largely repudiated conceptual concept of regulations, which does not start from the "system-wide" characteristics of risks and often misses key risks'.[76]

The starting point for Australian reform is where matrices identify a 90% greater or equal correlation between the selected variables.[77] Related party transactions and misleading and deceptive conduct are closely correlated (93.42%). There are high correlations between incidences of dishonesty, related parties/conflicts of interest (95.31%), breaches of directors' fiduciary and best interest duties

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[70] de Jersey, above n 36.
[71] Pistor, above n 25, 1666.
[72] Ibid.
[73] Nuncio D'Angelo, 'The CAMAC Report on managed investment schemes: Another opportunity missed?' (2012) 23 *Journal of Banking and Finance Law and Practice* 253, 254.
[74] Claessens and Kodres, above n 4, 2.
[75] Ibid.
[76] Ibid 4.
[77] App 2.

(95.31%), and failures in disclosure (92.97%). Tactical implementation can be achieved through the harmonisation of directors and trustee duties, reform of the use of trusts as commercial investment entities, and the international harmonisation of Australian corporate governance and financial product standards.

Specifically, IOSCO, Financial Stability Board, MiFID 1 and 11, embrace of the Global Corporate Governance Standard,[78] licensing and capitalisation, and asserting the primacy of fiduciary and fiduciary-like responsibility. Consistency between in-country reforms and globally is sound policy. To not achieve at least these results risks the Australian NBFE funds management industry becoming a global outlier with negative economic consequences. These strategies may also render reform less politically contentious. IOSCO has a well-defined assessment and implementation process including for market confidence and integrity, investor protection, and reduction of financial crime.[79]

Risks will remain: 'a fully "fail-proof" financial system may not be the most efficient in delivering economic growth or other desirable outcomes',[80] including the development of financial literacy competencies as an alternative to libertarian paternalism. There could be 'less emphasis on formal rules and give more discretion to [reformed] supervisory agencies … perhaps avoid the proliferation of rules that may add more costs than they provide benefits and may even increase overall risks',[81] a suggestion consistent with this thesis.

Harmonisation includes the need to address the scope and importance of applying fiduciary principles to governance of the NBFE sector. The objective should be quality assurance of the investment chain for the benefit of the financial consumer. This is an accepted principle in other scholarly disciplines. Presently, there are differing statutory interventions ranging from none to significantly prescribed statutory fiduciary duties in the governance of superannuation entities, a greater statutory intervention than embodied in the *Corporations Act*. The backgrounds of directors and trustees influence their understanding of and implementation of fiduciary principles, and the personal risks they assume arising from these roles. There are directors of responsible entities (REs) of MIS who do not understand that a responsible entity is also a corporate trustee, subject also to trust law.

The duties and responsibilities of directors and directors of trustees and registered organisations are not consistent across the *Corporations Act*, *Superannuation Industry (Supervision) (SIS) Act*, and

[78] Centre for Fiduciary Excellence LLC and fi360 Inc 11, 'Prudent Practices for Investment Managers: Defining a Global Fiduciary Standard of Excellence' (2013 Worldwide edition).
[79] IOSCO, *Impact Assessment Guidelines* (July 2011) [1.5].
[80] Claessens and Kodres, above n 4, 12.
[81] Ibid 23.

Fair Work (*Registered Organisations) Amendment Act*. Inconsistencies in the law have led to opportunistic behaviour by some directors and trustees. Whilst arguably complying with statute, they do not follow the spirit of the law and do not optimise investor outcomes. In some cases, despite the provisions of statutes and general law, shareholders and unitholders have been asked to approve, usually through a sequence of transactions, often between related parties including directors and entities controlled by them, outcomes which are suboptimal and which enrich those who govern the NBFE. Sober analysis reveals outcomes which, had they been concluded in a single transaction, would be prima facie cases of non-, mis- and malfeasance.

There is considerable systemic risk generated by related party transactions and consequential conflicts of interests and objectives. These occur in a complex investment chain controlled by multiple intermediaries and is incompatible with the concept of a fiduciary having stewardship of client property. Related party transactions are common in NBFEs. Present financial advice regulation is directed at prioritisation rather than prohibition of conflicted dealings. For financial products subject to trust general law or its statutory implementation in the *SIS Act*, there is prohibition, although not exclusively.[82] Murray[83] noted that there is increasing industry consolidation and vertical integration. This results in increasing number of related parties and increased potential for conflicts of interest.[84] Directors are often placed in situations of conflict of interest and conflict of economic objective by virtue of the architecture of their organisations.

The law governing the supply of financial products and services by NBFEs is a field where opposing political, social, and economic interests compete intensively.[85] NBFEs and their regulators operate in a political milieu. It is assumed that there is a level playing field in Australian regulation. This may not be the case. Some NBFEs have better access to agents of the state than others and governance structures that can influence political outcomes unavailable to others.[86]

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[82] APRA, *Conflicts of interest* (at July 2013) Prudential Standard SPS 521.
[83] Murray, above n 62.
[84] ASIC, *Culture, conduct and conflicts of interest in vertically integrated businesses in the fund-management industry* (Report 474, March 2016).
[85] de Jersey, above n 36.
[86] Cheffins, 'Corporate Law and ownership structure', above n 19, 361.

6. THE ECONOMIC EFFECT OF INACTION

The financial system is based on trust.[87] Whilst there are some compensation arrangements in place in Australia, notably for APRA regulated superannuation funds, and remedies sought as a result of successful class actions, for the most part, investors have not been compensated.[88] In this sample, a 4.24% remediation result. This has three direct and lasting results: investors lose trust in the financial system and stop or reduce investing,[89] capital availability becomes restricted and economic activity is reduced, impoverishment ensues, increasing welfare reliance.

There is a considerable historical literature on the relationship between law and economics. These include assertions of efficiency and inducement of efficiency of common law based on judicial interpretations of fairness, justice, and rights;[90] legislative capture by special interest groups;[91] the economics of models of regulation;[92] and legal empirical analysis.[93] ‘There is a very general need for empirical work on the legal system to be undertaken’.[94] That includes definition of efficiency: economists apply consumer welfare benefit rather than legal efficiency. In Australia, examples of legislative capture include the FoFA and registered organisation reforms, both contested by interest groups and politicised. Reform of superannuation fund governance remains contested. Each of these examples should be subjected to the spotlight of empirical legal analysis to improve economic outcomes for their respective financial consumers.

That the Australian economy has not developed its innate entrepreneurial qualities into an ecosystem comparable with the US[95] and Germany is in part a result of legal uncertainties and complexities. Risks include permanent life changing personal consequences of being a director, trustee, or officer

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[87] Chris Bowen, 'Overhaul of Financial Advice' (Media Release No 036, 26 April 2010).
[88] ASIC, *Compensation for retail investors: the social impact of monetary loss* (Report 240, May 2011) 13-14; The Australian Government the Treasury [Richard St John], 'Compensation Arrangements for Consumers of Financial Services: Future of Financial Advice' (Report, April 2012) iii ['FoFA'].
[89] Organisation for Economic Cooperation and Development, 'Governance of Collective Investment Schemes' (White Paper, 2005) <http://www.oecd.org/daf/financialmarkets>.
[90] Richard A Posner, *Economic Analysis of Law* (Aspen Publishers, 2011) cited in Lewis Kornhauser, ‘The Economic Analysis of Law’ in Edward N Zalta (ed), *The Stanford Encyclopedia of Philosophy* (Metaphysics Research Lab, Stanford University, Fall 2017) <https://plato.stanford.edu/archives/fall2017/entries/legal-econanalysis/> 4.
[91] Simon F Deakin, ‘The legal theory of finance: implications for methodology and empirical research’ (2013) 41 *Journal of Comparative Economics* 338.
[92] Cento Veljanovski, *The Economics of Law* (Institute of Economic Affairs, 2nd ed, 2006) 145.
[93] Richard A Posner, ‘The economic approach to law’ (1975) 53 *Texas Law Review* 757, 782 cited in Louis Kaplow and Steven Shavell, ‘Economic Analysis of Law’ in A J Auerbach and M Feldstein (eds), *Handbook of Public Economics* (Elsevier Science BV, 2002) vol 3, ch 25.
[94] Kaplow and Shavell, above n 93, vol 3, ch 25 [7.3] 1765.
[95] See, eg, Bernard Salt, ‘What happened to the spirit of the Aussie entrepreneur?’, *The Weekend Australian* (Sydney), 10–11 March 2018.

seeking to balance entrepreneurial opportunity with capital preservation. Foregone economic activity is also a function of the loss of capital quantified in Chapter 3 and consequential risk aversion of Australian investors, institutional and private, from the losses resulting from an inchoate regulatory system. It is not possible for a risk seeking entrepreneurial ecosystem to grow sustainably with such a loss of capital. Hence the paucity of capital availability for Australian SMEs. These companies wither.

Some authors[96] claim causality between legal origins and financial market outcomes, a primary legal distinction being common and civil law origins.

> Legal protections not only facilitate diversification of financial commitments by the existing investor base, but also and in addition, must encourage small investors to put their savings in equity. This then leads to the broadening of the investor base which is associated with bigger and deeper markets. Thus law begets markets.[97]

Comparative law research supports this conclusion, with differing legal methods achieving similar desired outcomes for securities investors. Similarly, differing jurisdictions change market practices using methods other than legal tools to implement policy reform: 'law is hardly ever the only or even the culprit of a crisis. Conversely, legal solutions are not necessarily the most important remedy … actual change is contingent on non-legal factors...'[98] The importance of behavioural economics research is understated and under-researched in Australia, where emphasis on statutory accretion serves as 'diagnostic tools for policy reform'[99] without applying the insights from comparative jurisdictions. Emphasis on objective strategy based on multiple tools in Australia would serve to reduce the impact of interest group driven politicised policy recently experienced in the financial planning and superannuation sectors.

Community expectations of, and trust in what each market participant should do has often been different from what they actually do. 'Be under no illusion, there is still a trust deficit between investor and customer…'[100] Ambiguities lead to a false sense of security which have been sadly and damagingly misplaced. 'Lilliputian battles … whose petty victories ... were trumpeted in the columns of their fawning acolytes in the press'[101] gave comfort that these problems were being resolved.

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96 Pistor, above n 25, 1113.
97 Ibid 1650.
98 Ibid 1669.
99 Ibid 1658.
100 Niall Coburn, 'Compliance challenges facing the financial services industry – how do I turn risk into opportunity' (Paper presented at Thomson Reuters Summit, Beijing, November 2017) 4.
101 A N Wilson, *Our Times* (Hutchinson, 2008) 411.

Wallis inspired principles of disclosure, advice, and financial literacy, whilst commendable, have been implemented with a certain naivety leading to severe personal and nationwide economic damage.

One court likened Australia's financial services and financial products industries to Dante's *Inferno*. It chose vivid adjectives 'byzantine' and 'purgatorial'.[102] This speaks loudly of the need for rational reform in the provision of financial products and financial services. Reform objectives must be to re-establish trust, confidence and respect, lost in several decades of often anonymous or poorly-informed financial product selling to vulnerable retail investors, despite repeated analysis and with similar conclusions from 2001.[103]

The goal of reform must be clearly directed at restoring public trust, confidence, and respect. Fundamentally, this requires recognition of fiduciary obligations to investors and beneficiaries often wrongly assumed by them to exist. Directors, trustees, and those that advise them are responsible. Often not deliberately dishonest, sometimes 'messianic'[104] but nonetheless not fit and proper in any meaningful sense.

The spirit of Wallis principles of disclosure are not always adhered to. Nor is disclosure always understood by readers. Disclosure has not prevented manifest conflicts of economic interest in the management of those activities. In the application of the second Wallis principle, financial advice, there is a distinction between the general law duties of skill and care and fiduciary obligation, constrained by associated contractual provisions in the relationship, and the *Corporations Act*. Investors may be surprised to learn that in 2018 there is no statutory fiduciary duty to the client in respect of this second limb of Wallis. The assumption that fiduciary principles always apply is false. They do not, and the fact that statutory application of fiduciary principles was proposed to apply to what was sold as professional advice speaks volumes for the corrupted ethical cultures of the organisations and individuals involved. It speaks loudly of systemic deficiencies in Australia's financial culture, but a deficient statutory solution. The modern fiduciary standard is a general law standard now subsumed by a statutory best interest duty.

General law principles of reasonable skill and care had not in many cases been applied either, with the financial advice and wealth management sectors being captured by a commission driven sales culture in large and small financial institutions. This is not the case in other jurisdictions. Even before

[102] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 [118] (Rares J).
[103] Lord Myners, above n 49.
[104] *ASC v Donovan* (1998) 28 ACSR 58 (Cooper J).

Hayne,[105] large Australian financial institutions added to the unease by needing to compensate clients for advice that was contracted but not provided. Whilst this is not of itself a breach of fiduciary duty, it underscores legal uncertainty in the mind of a layperson, a financial consumer. Fiduciary duties in Australia are not directly concerned with the quality of advice, although that quality may differ depending on whether any fiduciary duty obligations are discharged or not. However, the law still provides a basis for corruption of these principles by not making a clear demarcation between financial products sellers and financial products advisers. There is still the basis for conflicts of interest to arise, including arising from fee structures.

In the US, there is a similar debate, politicised as in Australia, also extending to the regulators. Retail investors (Moms and Dads) typically are exposed to brokers and, separately, investment advisers. There has been no uniform fiduciary standard for brokers and investment advisers, although there has been a best interests test. Brokers have typically earned a fee from product manufacturers and mutual funds whilst making suitable recommendations and in some cases managing client accounts, whereas investment advisers typically earn an asset based fee. The US Securities Exchange Commission (SEC) intended a uniform fiduciary standard for all retail investor retirement advice. The SEC has the regulatory power under *Dodd-Frank*[106] but political division and continued lobbying has prevented implementation. Financial professionals who provide advice related to retirement monies must act as fiduciaries (in the US interpretation of fiduciary) and brokers who manage retirement monies must act with best interest, and similarly for non-retirement accounts where they have investment discretion or asset related fees. Fiduciary responsibilities are to be underpinned in enforceable best interest contracts. Judicial review in the US and Canada has extended fiduciary relationships 'to be used for creating new forms of civil wrong', being from an Australian perspective an 'unsatisfactory development of the law of fiduciary obligation'.[107]

Investors may also be interested to learn that a custodian in Australia does not necessarily have the meaning assumed by an investing layperson. There is a disconnection between public expectation and industry practice. Many people assume that the mere attribution of the custody title confers fiduciary duty and protection to an investor akin to a trustee. It does not. Deficiencies in the Australian custody sector were identified in 2003 and Australian law does not follow international standards.

[105] Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (2018) (Commissioner Hayne).
[106] *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* (United States) Public Law 111 - 203.
[107] *Westpac Banking Corporation v The Bell Group Ltd (in liq) [No3]* [2012] WASCA 157 [901] (Drummond AJA).

Arguably the Australian custody sector has been charging fees commensurate with community service expectations but without providing a level of service and risk mitigation assumed by investors. The investing public does not necessarily understand the legal nuances between a managing trustee, and a custodian trustee, nor the distinction between a custodian trustee and a bare trustee.

7. COMMUNITY EXPECTATIONS — DISCONNECTION WITH THE TWIN PEAKS MODEL OF REGULATION AND SUPERVISION

Community expectation is tempered by belief systems, behavioural norms, and financial competencies leading to systemic misunderstandings based upon 'limited ability to unravel risks...'[108]

Discussion of expectation, culture, and intervention is incomplete without a wider view of the value to individual investors and the entrepreneurial economy of investors having access to various types of financial product, including MIS. Should the libertarian paternalism espoused by Cooper[109] in respect of superannuation investment be copied in these other investment asset classes? If so, what is the effect on the entrepreneurial economy? At an individual level, would such policy enhance financial literacy? Probably not, since impairment of capital is one element of understanding risk. Some jurisdictions do restrict retail investor access to many types of financial product,[110] a consequence being more reliance on government and less individual endeavour. However, this is not the optimal response to the systemic problems in Australia. 'Where should responsibility for citizens' longer term financial security lie?'[111] Policy conflicts arise from investor realisations post-NBFE collapses where 'little active supervision is revealed, financial consumers are incredulous, angry and mistrustful'.[112] Disclosure assumes that 'all investors are the same'[113] and make informed decisions. This is not the case, despite their having responsibility for decision making. In Australia, there are 'limited and sparse existing programs of investor education and assistance',[114] with ASIC concluding that 'investor education is worthwhile though it must be pursued in the long term in tandem with other strategies that build in the fact that retail investors are not the hard-headed decision makers often supposed.'[115] Implicit recognition of the importance of behavioural economics theory.

Expectations gaps between regulators and stakeholders 'resonate today, arising as they do out of legal and technical difficulties in applying a single regime to a disparate collection of investment and quasi-investment arrangements that utilise different legal forms and are used for different commercial

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[108] Christine Brown, Colm Tussler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure' (2011) *The Finsia Journal of Applied Finance* 11.
[109] Cooper, above n 51.
[110] Dimity Kingsford Smith, 'ASIC regulation for the investor as consumer' (2011) 29 (5) *Companies and Securities Law Journal* 336.
[111] Ibid 353.
[112] Ibid 354.
[113] Ibid 329.
[114] Ibid 334.
[115] Ibid 338.

purposes'.[116] This is particularly so for unregistered MIS and those common enterprise MIS where there may be no tangible trust property, investor benefits being limited to choses in action, sometimes only exercisable through conflicted power of attorney. Desire for retribution from those aggrieved is compounded by ASIC not choosing 'to use enforcement as a primary means of shaping MIS jurisprudence'.[117] More recent policy directions to address culture, director and investor education seek to facilitate its mandate by lifting ethical and educational standards across its regulated universe, with the proposed caveat of statutory criminal penalties on those responsible for poor organisational culture. If continued, these strategies are generational and rebalance ASIC as a Responsive Regulator, less reliant upon statutory compliance and more focussed on the import of fiduciary concepts.

One of the benefits of Australia's Twin Peaks model is the application of differing approaches to similar problems. A primary difference between ASIC and APRA (and the Registered Organisations Commission) is the number and diversity of NBFE entities regulated. APRA is more closely involved with its regulated entities through ex ante supervision than ASIC with its ex post market conduct model, until recently largely adversarial, relying on court based enforcement.[118] The former makes for relational regulation based upon earlier interventions. ASIC's recent focus on culture and education makes for a more relational environment: Responsive Regulation. This form of regulation 'champions internalisation … it is usually impossible for society to organize its resources so that rewards and punishments await every act of compliance or non-compliance'.[119] The objective is to achieve compliance by internal means, sometimes underscored by means of enforceable undertakings,[120] commonly used in Australian financial services and financial products regulation.

Active involvement (common in prudentially regulated entities) can diffuse required behaviours into NBFE governance and at many levels of the entity, not just its compliance management. This would require additional skills sets in ASIC to embrace microeconomic analysis and its inclusion in disclosure documents. It would be an ex ante extension of present licencing powers to prevent, restore and rehabilitate. It balances its ex post adversarial powers. 'This would mean a cultural change in firms and the board and senior management working to change the acceptance of regulators in

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116 Pamela Hanrahan, 'ASIC and managed investments' (2011) 29 *Companies and Securities Law Journal* 297.
117 Ibid 289.
118 See, eg, Helen Louise Bird et al, *ASIC Enforcement Patterns* (Centre for Corporate Law and Securities Regulation, University of Melbourne Law School, 2003).
119 Dimity Kingsford Smith, 'A harder nut to crack? Responsive Regulation in the financial services sector' (2011) 44 (3) *University of British Columbia Law Review* 702.
120 Ibid 704.

firms'.[121] Such policy does not have the 'public drama of prosecutions', requiring political will.[122] Lack of public confidence has resulted in ASIC's review of its Australian Financial Services Licence (AFSL) and Credit Licence banning powers concurrently with the introduction of the Banking Executive Accountability Regime (BEAR) for ADIs.[123]

[121] Ibid 738.
[122] Ibid 741.
[123] Australian Government The Treasury, 'ASIC's power to ban senior officials in the finance sector' (ASIC Enforcement Review Position and Consultation Paper, 6 September 2017) 1.

8. COMMUNITY EXPECTATIONS — GAP WITH MARKET PRACTICES IN THE GOVERNANCE OF FINANCIAL PRODUCTS AND SERVICES

A consumer of financial products and services is often vulnerable because of lack of experience and expertise in investment. This vulnerability should enliven fiduciary obligations. The important characteristic of a fiduciary relationship is one of trust and confidence, the fiduciary acting for or on behalf of the interests of another.[124] The fiduciary power must be exercised in the interests of the investor or client with no unauthorised profit or conflict accruing to the fiduciary. Fiduciary relationships should occur at every point in the investment chain where there is discretion or advice. Economic interest of the ultimate consumer should be paramount. The beneficiary must have confidence in the agent even if that agent is several steps removed. Trust in the investment chain is only as 'strong as the trust in the weakest link of that investment chain'.[125] Defining status-based fiduciaries is fundamental.

Directors are often placed in situations of conflict of interest and conflict of economic objective by virtue of the architecture of their organisations. Considerable systemic risk is generated by related party transactions and consequential conflicts of interests and objectives. These occur in a complex investment chain controlled by multiple intermediaries and is incompatible with the concept of a fiduciary having stewardship of client property. Related party transactions are common in NBFEs.

Present financial advice regulation is directed at prioritisation rather than prohibition of conflicted dealings. For financial products subject to trust general law or its statutory implementation in the *SIS Act*, there is prohibition, although not exclusively.[126] Murray[127] noted that there is increasing industry consolidation and vertical integration. This results in increasing number of related parties and increased potential for conflicts of interest.[128] ASIC's report particularly relates to financial product manufacturing and distribution, outsourcing, fiduciary obligations, remuneration, ownership interests, and use of information. These and other conflicts also arise in prudentially regulated NBFEs. ASIC specifically suggests 'better training for directors',[129] the 'engagement of separate external legal

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[124] *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)* [2007] FCA 963.
[125] John Kay, *The Kay Review of UK Equity Markets and Long Term Decisions Making* (Final Report, July 2012) 65.
[126] APRA, *Conflicts of interest* (at July 2013) Prudential Standard SPS 521.
[127] Australian Government The Treasury, *Financial System Final Report* (2014).
[128] ASIC, *Culture, conduct and conflicts of interest*, above n 84.
[129] Ibid 106.

advisers' in conflicts of a fiduciary nature,[130] and cultural responses to conflicts management [131] to disrupt 'systemic conduct that is driven by poor culture'.[132]

But, conflicts and the taking of profits have often arisen permitted by the subsuming of fiduciary principles by contract and statute. *Australian Softwood Forests* is an example at the commencement of this study period:

> The schemes are generally designed so that all the investors ever receive are the pieces of paper constituting the agreements … promoters design increasingly more sophisticated schemes in attempts to circumvent the laws.[133]

Directors of companies and trustees have differing fiduciary responsibilities. 'As a general rule, all powers vested in directors under the company's articles are fiduciary powers to be exercised in the interests of the company'.[134] Fiduciary responsibilities are also set out in statute, specifically the *Corporations Act* and *Superannuation Industry (Supervision) Act*, but not in the *Fair Work (Registered Organisations) Amendment Act* where general law fiduciary duty traditionally applied in the context of dependence.

The director of a trustee and a director of another entity associated with the asset can concurrently be the same person managing the same underlying assets. This is one of many conundrums leading to uncertainty in NBFE governance. Harmonisation of fiduciary duty across the governance of the NBFE sector is required to eliminate inconsistency in the law. Like the cleansing effects of economic recession, a statutory prohibition on conflicts of interest is required to eliminate ambiguity, uncertainty, and redevelop lost confidence in a market based regulatory system. Statutory interventions prioritise not prohibit. This is dangerous for beneficiary, client, and trustee director alike. They do not resolve the cultural problems identified by Heydon, opining that poor culture drives poor conduct.

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[130] Ibid 123.
[131] Ibid 168.
[132] Ibid 28.
[133] *Australian Softwood Forests Pty Ltd v A-G (NSW); Ex Rel Corporate Affairs Commission* [1981] HCA 49 [37] (Murphy J).
[134] *Westpac Banking Corporation v The Bell Group Ltd (in liq) [No3]* [2012] WASCA 157 [1949] (Drummond) AJA.

There is no controversy over the existence and scope of a fiduciary's fundamental proscriptive duties, although there may be [is][135] over the precise nature and extent of them.[136] There is 'no standard test to be applied to determine whether the parties are within a fiduciary relationship'.[137] It depends on the facts and the context, including 'contractual arrangements'.[138] The essence of the fiduciary relationship is the exercise of power by one party for the benefit of another, the principles being:

> unless there are some special circumstances in the relationship, the duties that equity demands from the fiduciary will be limited to what he described as the 'two core obligations' relating to unauthorised benefits and conflicts of interest.[139]

The determining factor is 'the well-established rule that the scope of the fiduciary duties in a particular relationship will vary and is to be determined according to the nature of the relationship and the facts of the particular case'.[140]

The need to analyse each discrete case for fiduciary obligation strikes at the heart of the systemic cause of the chasm between client or investor expectations and market practices in financial services advice or financial products selling. There have been misplaced expectations by investors in NBFE financial products and services transactions that there is a relationship based in fiduciary principles. Part of the mismatch in expectations has been poor financial literacy and misunderstanding of the law (including fiduciary law), but part is innate trust based on fiduciary principles assumed by investors in professional persons with whom they deal.

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[135] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Interim Report* (December 2014), ch 4, s 2.5, 42 (Commissioner Heydon).
[136] Ibid; *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* [2012] WASC 157 44 (Owen J).
[137] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [836] (Lee AJA).
[138] *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64 [102] (Gibbs CJ, Mason J).
[139] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [1944] (Drummond AJA).
[140] Ibid [1970] (Drummond AJA).

9. THE EXPERIENCES OF COMPARATIVE JURISDICTIONS

Australia is not unique: other jurisdictions have implemented a variety of solutions to remedy comparative systemic deficiencies. This study of comparative jurisdictions is insightful: '[C]ross-country differences in legal systems and accounting standards help to explain the cross-country differences in the development of financial intermediaries'.[141] '[C]ountries with a German legal origin have better-developed financial intermediaries…'[142] with particular insights into regulatory posture, fiduciary-equivalent obligation, and the relationship between regulation and corporate governance. Of the common law jurisdictions, Canada has the closest affinity with the traditional German civil law model. Germany has the closest pure liability model of all of the jurisdictions studied. When Germany in 2007 departed temporarily from its legal traditions in NBFE regulation, it suffered results similar to those in Australia: 'Heuschrecken'[143] descended, necessitating reversion to legal traditions, now codified in EU statutes.

These insights are of practical relevance, if emulated could significantly improve Australian law and regulation. They provide the basis for the re-establishment of investor trust and confidence and enhancement of national economic productivity. Inter-jurisdictional transfer difficulties can arise, but the more successful regulatory experiences in comparative jurisdictions provide reform options to address identified systemic deficiencies in Australia. These experiences fall into two distinct categories – strategic policy reforms and tactical statutory reforms.

The German (EU), Canada, US, UK, and Singapore jurisdictions demonstrate there is no one solution to the resolution of systemic problems in those jurisdictions and manifested in Australia. These experiences fall into two distinct categories – strategic policy reforms and tactical statutory reforms. They will require amendment to Australian statutes.

For example, if Australian NBFE directors were subject to German (now EU-codified) duty of care civil law *untreue* and *culpa in contrahendo* fiduciary-like doctrines (in their proscriptive and prescriptive formulations), supreme rather than subordinate, they would be less likely to hide behind statutory and contractual box-ticking. For Australian investors, it would extend duties of advisers beyond present statutory best interest with a personal conduct obligation to explain, fully disclose, deal fairly and positively pursue their economic interests. German legal tradition has facilitated the maturity of its private banking sector, yet to be emulated in Australia. In Germany, investors are now

[141] Carmichael and Pomerleano, above n 2, 13, citing Levine, Loaya and Beck, above n 13.
[142] Ibid 199, citing Levine, Loaya and Beck, above n 13.
[143] Locusts [author's trans].

consumers of financial products and services, not capital suppliers in a NBFE market. This is a completely different posture to Australian market practice.

Canada has significantly extended fiduciary doctrine across the investment chain, adopted Responsive Regulation, with NBFE directors and financial advisers having a direct, prescriptive fiduciary nexus with whom they deal. By contrast, NBFE regulation in the US is a politicised, convoluted, unresolved, inconsistent mess blowing with the political winds of the day. Its fragmented regulatory architecture, which has led to jurisdiction shopping, 'has been heavily discredited'.[144] The UK has attempted to quality assure its investment chain by proposing substantially extended fiduciary obligation, eliminating legal ability to contract out of that obligation, and extending it to end beneficiary. To date, those attempts have failed. Singapore has a national strategy of being a global finance hub. Regulatory veracity has been achieved using other methods. These include statutory personal liability in financial advice, personal fiduciary liability for directors of actively managed collective investment schemes (CIS) regulated by its *Business Trusts Act*[145] (the equivalent of small unregistered MIS in Australia), and much greater barriers to entry for NBFE market participants.

[144] Symposium, 'Global Financial Crisis: The Way Forward' (9 April 2010) Bond University; Carmichael, 'Regulatory Lessons from the Crisis', above n 7.
[145] *Business Trusts Act* (Singapore, Act 30 of 2004).

10. IMAGINE

You are a director of an Australian company which holds an AFSL and acts as RE of a number of MIS, in-house and for third parties. It has multiple international subsidiaries and operations. The company owns a wealth management business which employs and authorises a number of financial advisers. It also has a Registrable Superannuation Entity (RSE) License to act as trustee of superannuation funds of various forms and, as RSE, is responsible for investing those funds inter alia into managed investment schemes for which it is also the RE. Some of those invested funds are superannuation industry default funds. Your officers are often asked by beneficiaries and investors to advise them on their superannuation and other investment arrangements. The capital structure is complex with a mix of securities on issue. There are multiple senior and junior banking facilities and a related party finance company. Your company is proposed to be acquired by a foreign company. The foreign company is based in Canada and its shares are publicly quoted on a US securities exchange. It manages a UK pension fund. Such scenarios have been commonplace. Increasingly so as NBFE sector consolidation occurs encouraged by regulators seeking scale and fee reductions in the NBFEs they regulate.[146]

What are your duties? How do you balance the exercise of them in governance of entities which are subject to multiple and inconsistent law? Where do you find a summary of your duties? What are your options should you disagree with the proposals of other directors? Do you assume personal liability? If so, how and when? What constitutes an appropriate set of board papers? You step up into the role of chair of the board. How do your responsibilities change?

There has been significant judicial intervention and extra-curial review of these complex governance problems:

> The intent of the business judgment rule was to balance directors' duties and liabilities with the needs of an independent corporation to engage in 'economic entrepreneurship', and to avoid the evisceration of companies such that none could make serious commercial decisions without the daily approval of lawyers.[147]

'Rather than add certainty, AICD submits that the result will be to increase uncertainty'.[148]

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[146] Helen Rowell, 'Australian Prudential Regulation Authority' (Paper presented at the Australian Financial Review National Policy Series Banking and Wealth Summit, 2015).
[147] L Law, 'The Business Judgement Rule in Australia: A Reappraisal since the AWA Case' (1997) 15 *Companies and Securities Law Journal* 174; Kirby, above n 12.
[148] Australian Institute of Company Directors, Submission to Mr Joe Hockey, Parliament of Australia, *The process of Law Reform CLERP s 181 and s 189 and the Business Judgement Rule*, 17 March 2000.

> The law governing the imposition of duties upon persons who act for or on behalf of corporate entities should be clear, simple, and as far as reasonably possible, certain of application. In my opinion, the current law does not meet these objectives.[149]

> The respective roles of the board and senior management and the resulting allocation of responsibilities is a fundamental aspect of corporate governance … if the balance is not appropriate, the fundamental governance structure of the company will be flawed and may lead to poor company performance.[150]

Companies are regulated by the *Corporations Act*, *SIS Act* (where superannuation and insurance entities are involved), the Australian Securities Exchange (ASX) *Listing Rules* (for publicly quoted companies in Australia listed on the ASX), and the general law. The ASX *Listing Rules* require companies to have an audit committee, but not a risk committee, although it is common for NBFEs to have risk committees advising their boards.[151] A study of the top 20 ASX listed companies and a sample of 10 small capitalisation companies reported that 'ninety per cent of the top 20 companies listed determination/approval of financial reports as a responsibility of the board but only 30% of the small capitalisation companies did this'.[152] Most NBFEs are of small capitalisation. Given that the financial services entities in this research sample included AMP, ANZ Bank, Commonwealth Bank, Macquarie Group, National Australia Bank, QBE Insurance, Suncorp Group, and Westpac Banking Corporation,[153] each and all of whom have had systemic and cyclical failures in at least their NBFE operations, illustrates that their corporate governance arrangements have not worked as they should.

For the most part, directors of Australian NBFEs are lay people, not professional directors.[154] Large corporate entities tend to be governed by individuals with claim to professional competencies but this is not the norm in NBFEs. Neither are the individuals holding these positions appropriately

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[149] Commonwealth, HIH Royal Commission, *The Failure of HIH Insurance Final Report* (April 2003) app 2, 95.
[150] Financial Services Council, *Corporate Governance: A Guide for Fund Managers and Corporations* (Guidance Note 2, June 2009) [11.14]; see also, Reegan Grayson-Morison and Ian Ramsay, 'Responsibilities of the board of directors: a research note' (2014) 32 *Companies and Securities Law Journal* 69.
[151] Ibid 75.
[152] Ibid 69.
[153] Ibid 72.
[154] The AICD reports membership of approximately 38 000. See, generally, letters from AICD to ASIC, 7 July 2016 (Consultation Paper 257 Improving disclosure of historical financial information in prospectuses), and 14 July (Charitable Fund Raising Review). AICD does not publish statistics on the number of persons attending its training courses. ASIC also identify a need for improved director training. See, eg, ASIC, *Culture, conduct and conflicts of interest in vertically integrated businesses in the fund-management industry* (Report 474, March 2016) 106. M Scott Donald uses the terminology 'lay trustees' in Donald, '"Best" Interests' (2008) 2 *Journal of Equity* 245, 246. See also Kevin Yi Liu, *Australian Superannuation: Operational Structure, Investment Performance and Trustee Governance* (PhD Thesis, The University of Sydney, 2013) 279–80.

remunerated to be able to devote sufficient time for study and analysis of the law to properly understand its evolution and application. They therefore place considerable reliance upon third party advisers, a path that is increasingly dangerous for them.

11. STATUTES AT VARIANCE — THE CREATION OF UNCERTAINTY IN DIRECTORS DUTIES AND TRUSTEE DUTIES

NBFE directors are confronted by overlapping and confused trust law, general law and statutory provisions. They can rarely be certain of their duties. This confusion extends to those who invest in their entities, their legal advisers and to those determining whether appointees meet fit and proper criteria,[155]. 'A legal vacuum has been created by the evolution of the trust as a vehicle for large scale enterprise, and the apparent tardiness of Australian legislatures to accommodate this development'.[156] '[T]rustee-directors should not have to collate rules from multiple sources in order to understand their core duties'.[157]

There are differing standards applying to director duties under the *Fair Work Act (Registered Organisations) Amendment Act*, *Corporations Act*, and *SIS Act*. Many NBFEs are multifunction financial institutions of considerable size subject to regulation by or the influence of each of these statutes.

Like Esau and Jacob, 'vying for power even in their mother's womb',[158] the jurisdictional differences in history, culture, and desire for specific types of governance lead to a zero sum game. Whilst there may be some tactical reform, these struggles for power and influence have not necessarily improved conditions for the people they purport to protect. 'Appointees [to the Fair Work Commission] are regularly described as "union friendly" or "employer friendly"' giving rise to 'claims of bias'.[159] Neither is there unanimity of professional opinion as to the solutions.[160] The *Corporations Act* impacts on 'ASIC's ability both to respond to the recommendations made in this report, and on its ongoing and future ability to fulfil its mandate efficiently and effectively'.[161] It cites 'legislative and regulatory complexity … and in particular the application of the *Corporations Act*'.[162] During the period covered by this thesis, its word count has increased from 257 419 to 729 056.[163] These concerns

[155] Farrar and Hanrahan, above n 67, [30.15].
[156] Nuncio D'Angelo, *Commercial Trusts* (LexisNexis Butterworths Australia, 2014) 119 [3.23].
[157] Cooper, above n 51, pt 2 ch 2, 46.
[158] Wilson, above n 101, 410.
[159] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 63, ch 2, 39.
[160] Michael Chaaya, Corrs Chambers Westgarth, *Australia: Stronger Super: a new dawn for trustee governance* (Mondaq Ltd, 2013).
[161] Karen Chester, Mark Gray, and David Galbally, 'Fit for the future: A capability review of the Australian Securities and Investments Commission' (Australian Government Treasury Report, December 2015) 133.
[162] Ibid.
[163] 2018 word count in c 3000 pages, excluding 250 Regulatory Guides, multiple class order exemptions, and 20,000 s 1322 exemptions. For a more detailed review, see especially Chia and Ramsay, above n 40, 389 who report word count data to 2015 citing <http://www.comlaw.gov.au/Series/C2004A00818>. This data for

are ‘shared by numerous members of the judiciary who note that ‘every significant amendment to the corporations legislation … has added substantially to complexity’ such that it is now “inescapably complex”’[164] ‘Treacherous’, ‘incomprehensible’, ‘as clear as mud’, are other judicial adjectives.[165] Cooper has previously proposed a rewrite of the *SIS Act* citing complexity grounds.[166] To add to the confusion, four recent reform proposals have failed or struggled to gain necessary political support,[167] with compromised reform to the governance of registered organisations finally enacted in December 2016.[168]

These sentiments are not new. ‘There is a point where company law ends and trust law takes over’,[169] not a distinction recognised by many directors. Many NBFEs, particularly MIS and superannuation entities, are trusts with a corporate trustee. Trust structures were not originally intended to be used for risk seeking commercial business activities, or to be leveraged with debt to fund those activities. An MIS is a trust. Trust law applies.[170] These distinctions apply particularly to unregistered and/or insolvent MIS, transfers of property by a fiduciary, superannuation entities, asset allocation decisions or cases involving Canadian and US participants.

For directors of complex NBFEs, these legal uncertainties, overlaid with beneficiary and investor expectations of value outcomes rather than rights make for difficult territory. In *Sino Iron*,

> To require that a defendant must actually appreciate that the relevant facts constitute a trust in law would favour the legally ignorant over the legally aware, when the facts and knowledge are otherwise identical.[171]

In *Immobiliari v Opes Prime*, ‘Again, one might justifiably question whether even the trained legal mind is capable of making such fine distinctions.’[172] ‘[T]here is a clear twin policy imperative for

2018 has been manually compiled from this source by computing the word count in six volumes of the *Corporations Act*.

164 Chester, Gray and Galbally, above n 161, 134 quoting Michael Kirby writing extra-curially in R Hinchy and P McDermott, *Company Law* (Pearson Education Australia, 2006).

165 Chia and Ramsay, above n 40, 391–2.

166 Cooper, above n 51, 327.

167 Superannuation Legislation Amendment (Trustee Governance) Bill 2015 (Cth); Fair Work (Registered Organisations) Bill 2013 (Cth); Fair Work (Registered Organisations) Amendment Bill 2014 (Cth); Fair Work (Registered Organisations) Amendment Bill [No 2] 2014 (Cth).

168 *Fair Work (Registered Organisations) Amendment Act 2016* (Cth).

169 Nuncio D’Angelo, ‘The trust as a surrogate company’ (2014) 8 *Journal of Equity* 306.

170 *Corporations Act 2001* (Cth) s 601FC(2).

171 *Sino Iron Pty Ltd & Anor v Palmer & Anor (No 3)* [2015] QSC 94 [144] (Jackson J).

172 *Imobiliari Pty Ltd v Opes Prime Stockbroking Limited* [2008] FCA 1920 [29] (Finkelstein J).

pursuing legislative reform of the *Corporations [Act]* law — to both simplify and contemporise the law'.[173]

Since trusts and MIS are not legal entities, they cannot become insolvent. There has not been a body of law developed to administer situations where the assets of the trust are not sufficient to meet the liabilities required to be discharged by the trustee or the RE, themselves normally contractually indemnified from those assets. Consequently, directors and trustees need to understand multiple and inconsistent statutory provisions, general law, and equity.

The insolvency provisions of the *Corporations Act* relating to formal administration, receivership, and liquidation do not apply to trusts and MIS. Registered MIS have some limited statutory provision,[174] not applying to unregistered MIS. The trustee or RE may become insolvent whilst it administers entities where their underlying assets are insufficient to meet creditor liabilities. There are also cases where the trustee or RE also administer trusts and MIS which are commercially sound, although the trustee or RE is not. Further complications arise where leverage, sometimes multiple layers of it, is part of the capital structure. For trusts and MIS which are listed on the ASX of other securities exchange, the listing rules apply to the trust or the MIS, but not to the trustee or RE and their directors.

Personal liability in commercial trusts is also different in the US, being statute limited for investors,[175] by trust law for trustees[176], and for investors in Canadian trusts by provincial statute.[177] In Singapore, its *Business Trust Act*[178] eliminates personal liability for unitholders whilst extending personal fiduciary liability of trustee directors to them.

[173] Chester, Gray and Galbally, above n 161, 135.
[174] *Corporations Act 2001* (Cth) Part 5C.9.
[175] The *Uniform Statutory Trust Entity Act 2009* (United States) § 304 cited in D'Angelo, *Commercial Trusts*, above n 156, 193 [4.105] codifies and synchronises state trust law through the *Uniform Trust Code 2000* (amended 2005) to regulate and clarify the use of commercial trusts in mutual funds and structured finance. See generally John H Langbein, 'Why Did Trust Law Become Statute Law in the United States?' (Faculty Scholarship Series Paper 496, 2007) <http://digital commons.law.yale.edu/fss papers/496>.
[176] D'Angelo, *Commercial Trusts*, above n 156, 193 [4.106].
[177] *Trusts Beneficiaries Liability Act 2004* (Ontario) s 1 cited in ibid 148 [395].
[178] *Business Trust Act* (Singapore, Act 30 of 2004) Cap 31A s 32 cited in D'Angelo, *Commercial Trusts*, above n 156, 149 [3.98].

12. THE CREATION OF UNCERTAINTY — W[H]ITHER AUSTRALIA?

There is no commonality of strategy and no policy consistency from the competing political parties. Empirical research demonstrates that ideological orientation influences regulatory policy.[179]

Despite Australia's elaborate regulatory architecture, which of itself created community expectations, Australia has a regulatory malaise in the NBFE sector which the inconsistencies of, and conflicts of interest in, public policy are ill-equipped to remedy. The current system is complex and ineffective.[180] The report into ASIC itself demonstrates clearly that there are 'broad systemic problems in the financial advice industry' which may recur.[181]

It is manifestly important that Australia subscribe to international regulatory standards and that its own funds management products and services can be readily available in other jurisdictions. As with financial literacy, this should be seen as a productivity measure. Financial products harmonisation with international standards could assist Australia develop commonality of strategy and consistency in public policy. It would also remove some of its systemic deficiencies in the regulation of financial products and services and improve access to capital for companies, another productivity measure.

Campbell's underlying philosophy was for government intervention principally to open markets. Structure and regulation were addressed by Wallis advising a policy of non-interference in the market but with more streamlined and disciplined industry structures. These were designed in part to reduce regulatory fragmentation and overlap (and hence the ability to treaty shop) and to eliminate regulatory gaps arising from regulator specialisation.

This led directly to the creation of APRA, the *APRA Act* requiring it to supervise prudentially regulated financial institutions including superannuation entities.[182] APRA absorbed and consolidated the prudential roles of the Reserve Bank, Financial Institutions Commission, and the Insurance and Superannuation Commission.[183] The Australian Taxation Office (ATO) presently has responsibility for the regulation of the SMSF sector, however it is an ex post environment and more focussed on

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[179] Laurenz Ennser-Jedenastik, 'Do parties matter in delegation? Partisan preferences and the creation of regulatory agencies in Europe' (2016) 10(3) *Regulation and Governance* 193.
[180] Tom Valentine, 'The Regulation of Investments' (2010) 27(3) *Economic Papers: A journal of applied economics and policy* 273.
[181] Australian Government, The Senate Economics Reference Committee, *Performance of the Australian Securities and Investments Commission* (June 2014) 377.
[182] *Superannuation Industry (Supervision) Act 1993* (Cth) s 10(1).
[183] Jennifer Hill, 'Why did Australia fare so well in the Global Financial Crisis?' (2012) Paper No 12/35 *Sydney Law School Legal Studies Research*, 21; *Australian Prudential Regulation Authority Act 1998* (Cth) s 3(2).

eliminating tax leakage from related party transactions rather than prudential oversight. *The Financial Services Reform Act* aimed to achieve a similar result for providers of financial products operating under the *Corporations Act*.

These later reforms of the non-prudentially regulated sector were consistent with Wallis. Wallis relies on disclosure of information, honest conduct, and the abilities of consumers in a competitive and free market to make informed decisions based on unconflicted advice. Twin Peaks in practice are now Triple Peaks with the passage of the *Fair Work (Registered Organisations) Amendment Act* in 2016.

APRA regulated entities are prudentially supervised: other collective investments are not. Australia has a market conduct disclosure based regime, not a merits based regime (although Cooper[184] moves towards the latter). Historically there has been no suitability requirement, no interventions power into financial product design, no prudential regulation of many financial products, and no licensing of investors.

Prima facie, there may be argument for combination of the regulatory functions into one entity since many NBFEs are regulated by both ASIC and APRA (and the Australian Competition and Consumer Commission [ACCC]). Superannuation trustees are regulated by ASIC, APRA, ATO, and Austrac. This argument does not survive insightful scrutiny.[185] All four regulators, in the same jurisdiction, are required to develop policy responses and manage problematic issues which have some commonality. Their differing powers and cultures result in differing responses. This is a useful outcome and leads to a more diverse regulatory response based on learning and differing knowledge bases which can be shared.

Whether there should be a single prudential regulator for the entire financial system was addressed in 1996,[186] and 2009.[187] There is a difference between a capital guaranteed promise (eg ADI deposits) and a promise made in a managed fund or non-APRA regulated superannuation fund which have no such capital guarantee. These are two completely different regulatory environments. Extension of capital guarantees, ultimately by governments or industry levies, leads to significant moral hazard arising from community expectations, which cannot be met.[188] The next step becomes political

[184] Cooper, above n 51.
[185] Valentine, above n 180, 273.
[186] Phil Hanratty, 'The Wallis Report on the Australian Financial System: Summary and Critique' (Research Paper No 16, Department of the Parliamentary Library Information and Research Services, 1997) 24.
[187] Mark Johnson, 'Australia as a Regional Financial Centre' (Financial Centre Forum Report, January 2010) 143.
[188] The HIH Claims Support Scheme and the Trio Capital Compensation Scheme for APRA regulated superannuation funds raised compensation expectations from investors not compensated in those schemes.

influence. Ultimately it can lead to financial collapses (eg former State Banks) that prudential regulation is designed to avoid. That is not to say that prudential regulation cannot be applied by ASIC to the managed funds industry, only that it has a different result to that applied by APRA.

The jurisdictional boundaries between the ISC (being the precursor to APRA) and the Australian Securities Commission (being the precursor to ASIC) resulted in 'problems of trust management being placed in the hands of the ASC'.[189] Public interest demands that the superannuation industry have its governance standards established and enforced. The *SIS Act* provisions, accordingly,

> reflect, or are emanations of, established common law rules … where statute and common law point in the same direction, it is, in my view, entirely appropriate to use such legislation to assist in illuminating the public interest in this matter. That interest is to protect investors from abuses of trust by ensuring proper standards are maintained in trust management and in trustee behaviour.[190]

There is a moral hazard in that investor expectations may assume that the regulatory system is designed as a zero failure policy. It is not. There needs to be realistic community expectations as to what regulation and supervision can achieve in practice.

Johnson[191] is of the view that the separation of responsibilities has served Australia well and that the separation of prudential and market behavioural assists in the balance of regulation and supervision. Both Johnson and Cooper believe that the APRA approach of measuring institutional risk of failure and the systemic risk of that failure, then determining a graduated response is consistent with Wallis.

Cooper did not favour a single regulator approach, and preferred a business: government efficiency model based upon a wider APRA mandate, closer working relationships between APRA and ASIC, enhanced resources for the ATO, and a Productivity Commission review five years thereafter. Cooper, without explicitly criticising Wallis, is intent on moving away from its paradigm under the guise of improving outcomes for members on the basis that 'members are not in a position to drive changes themselves';[192] ie Wallis' third limb of financial literacy has not worked in practice for superannuation NBFEs. Investor financial literacy is stated to be 'an important long term goal, but a compulsory superannuation system cannot depend on all its participants having the skills

[189] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windso*r [1995] FCA 1663 [365] (Finn J).
[190] Ibid [382] (Finn J).
[191] Mark Johnson, 'Australia as a Financial Centre: Building on our Strengths' (Australian Financial Centre Forum Report, November 2009).
[192] Cooper, above n 51, ch 10, 309.

necessary'.[193] Cooper is of the view that 'disclosure is a necessary, but not a sufficient, condition for ensuring that member interests prevail'.[194] This demonstrates a lack of confidence in Wallis' first limb. The remaining limb, advice, has been addressed elsewhere, but trustees are likely to have greatly extended obligations to members in the provision of advice.

Whilst Cooper does not envisage APRA's role extending to intervening directly in trustee decisions, trustee directors are now subject to significantly enhanced statutory liability for beneficiary outcomes. This has major implications for director appointments, remuneration, and insurance. The tradition of general law principles based regulation rather than prescriptive statutory regulation has led to differing interpretations by directors, the regulators, and the courts. There is inherent tension between principles regulation and the need for clarity and certainty in the exercise of director and trustee duties, sought to be achieved by statutory extension.

There is further tension between regulation and supervision.[195] The Wallis posture of regulation based on intervention proportionate to the problem is different from direct oversight of financial institutions. Superannuation entities are subject to ex ante supervision, often active. MIS and other NBFEs are subject to ex post conduct regulation. Harmonisation needs to occur with ASIC moving to an ex ante supervisory agency, funded from industry levies (implemented 2017), and applying prudential supervision to registered MIS and other NBFEs. This would be a good result for ASIC and improve its ability to meet community expectation without destroying the three central tenets of Wallis: disclosure, advice and investor empowerment. ASIC would be able to focus on necessary reform of the MIS sector envisaged by the Corporations and Markets Advisory Committee (CAMAC),[196] at least in part. This includes elimination of the poacher/gamekeeper problem and proper prudential capital arrangements for MIS. It would also diminish the consequences of damaging ex post regulatory action on third parties since the NBFE market would become accustomed to a culture of supervision, different from regulation. Restoring the prescribed interest dual party system does not of itself provide better investor protection, although it would considerably widen the opportunity for remedy in the absence of MIS prudential regulation.

The sources cited in this thesis sought to address many of the systemic problems attributed to disclosure and advice. For the market to hold directors to account, the third limb, investor

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[193] Ibid ch 1, 4.
[194] Ibid.
[195] John Laker, 'Enhancing the competitiveness of financial services-lessons learnt and opportunities for improvement' (Speech delivered at the International Financial Services Association Annual Conference, 6 August 2009).
[196] D'Angelo 'The CAMAC Report', above n 73, 256.

empowerment, as Cooper acknowledges, has limited success, and requires new strategy. *Corporations Act* amendments to improve investor empowerment apply only to companies, not to superannuation entities or registered organisations. Lifting financial literacy standards in Australia should be seen as a productivity policy and responsibility for its implementation given to an agency other than ASIC. Poor financial literacy is a common theme in the sources cited in this thesis.

The collapse of HIH in 1991 resulted in a Royal Commission which required early structural changes to APRA. It was the beginning of a philosophy shift from neo-classical market driven mechanisms to 'a more sceptical, questioning, and aggressive approach'.[197] It started the evolution from an ex post to an ex ante regulatory system. Later analysis followed this trend and recognised that honest disclosure alone aimed at removing information asymmetries is not sufficient where 'individuals are not inherently rational in their actions and decision making'.[198]

The alternative to investor empowerment is libertarian paternalism which has its own dangers. This philosophy of libertarian paternalism espoused by Cooper and enacted in a compulsory contributory superannuation system reform supposedly to 'maximise outcomes for passive superannuation fund members whilst allowing the actively engaged to select their own direction'.[199] Echoes of paternalism are to be found in MIS. For instance, the proposed liability of financial product manufacturers (normally fund managers) for the suitability of the product for specific investors is a preferred reform proposed by ASIC and includes a best interests duty and prohibitions or limitations on financial product availability. The result would be to extend product liability to the product originator and require them to have the infrastructure as if they were providing a potential investor with financial advice.

This philosophy is used to justify a greater scope for government regulation and involvement, and is manipulated in the governance of industry superannuation funds by the application of the *Fair Work Act* to superannuation contributions. Presently, the superannuation sector is largely outsourced to the private sector. Default funds, and replication of that strategy to managed funds more generally places enormous economic power in the hands of the trustees.

Without policy clarity in respect of the objectives of superannuation funds identified by Murray,[200] it is but a short step to their application for economic development objectives, especially in a

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[197] de Jersey, above n 36, 5; Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Interim Report*, above n 135, rec 26.
[198] Thaler and Sunstein, above n 27, 7 cited in de Jersey, above n 36, 7.
[199] Cooper, above n 51, 9, 17.
[200] Donald, 'Regulating for fiduciary qualities of conduct', above n 31.

constrained fiscal environment. By 2035, the Australian superannuation sector is expected to have AUD6.1 trillion under management,[201] of which approximately 50% would be in default funds. These economic development objectives may include infrastructure investment, venture capital, government securities, and other sectors which are adept at influencing the political milieu. There are already examples in the industry superannuation fund sector, and including where there are related parties. '"Investment strategy" is not anywhere defined in the *SIS Act* … there is little guidance provided as to what constitutes an investment strategy nor of the level of detail required'.[202] Peer pressure, whether it be from similar funds, government policy objectives, or community views, can easily lead to trustee diversion 'from their single minded pursuit of members' interests by the clamour…'[203] What may constitute best interest in the pursuit of peer performance in other jurisdictions cannot necessarily be translated to Australia.

It is a short step to part nationalisation of some of these funds, particularly default funds, with the management subsumed into government agencies,[204] already publicly suggested. This may suit the proponents of libertarian paternalism, and there are obvious arguments to support such a strategy.[205] 'A public sector solution is likely to be most efficient, provided the annuitisation is compulsory'.[206] Such a policy would do little to meet the Wallis objectives of investor empowerment.

Murray[207] supports the present regulatory architecture. Murray expresses concern about political intervention and makes the point that governments have an obligation to act in the long term national interest rather than using the financial system for short-term political gain. Policy stability and lack of clarity as to objectives are key findings in Murray since they can lead to political influences and the corruption of the system. Murray has sounded the warning bell. The Murray approach is for tactical incremental reform provided these basic strategic issues have been addressed. Whilst he 'highlights [Australia's] reliance on imported capital … and that unfair consumer outcomes remain prevalent',[208] there was no analysis of the underlying causes. These include the incidence of

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[201] Cooper, above n 51, pt 1 app C: Treasury assumptions for modelling 72. Nominal 2018 equivalent AUD3.2 trillion.
[202] M Scott Donald, 'Prudence under pressure' (2010) 4 *Journal of Equity* 44.
[203] Ibid.
[204] For example, the Singapore Central Provident Fund, Future Fund, Queensland Investment Corporation.
[205] Michael Sherris and John Evans, 'Longevity Management issues for Australia's future tax system' (Australian School of Business, University of New South Wales, August 2009) 15.
[206] Ibid 38.
[207] Murray, above n 58.
[208] Jeffrey Carmichael, 'Report tinkering doesn't fix incentives problem', *Australian Financial Review* (Sydney), 15 December 2014.

malfeasance arising from injudicious incentives based on prioritisation rather than prohibition, often with related parties.

13. CULTURE AND 'TAINT'

Heydon[209] starts to explore the interface between the financial system and registered organisations. He identifies different standards for their directors and officers. The influence of criminality in registered organisations is of importance to the financial system given their influence over it directly and through their ASX shareholdings. Australia is known around the world as having the fourth largest pool of superannuation savings, and given their projected growth, identifying and removing systemic deficiencies is of national importance. Heydon[210] is insightful and provides plentiful evidence to support the hypothesis of systemic and cyclical malfeasance. It also identifies two of the primary causes: deficiencies in regulation aided by an 'unhealthy culture'.

Statutory intervention into rectifying deficiencies in culture is not restricted to registered organisations. 'Poor cultures, unsustainable business models, conflicted [financial product] distribution, and conflicts of interest'[211] are sought to be eliminated by extending criminal sanctions to directors and officers. The thesis that poor culture drives poor conduct is of itself an admission that lack of effective enforcement of fiduciary obligations requires criminal remedies similar to those that presently exist in the *Criminal Code*.[212] Whilst not deviating from its ex post posture to the extent of *SIS Act* supervision — 'we, as the regulator, won't be looking over everyone's shoulder to test their culture. We won't dictate how a business is run',[213] nonetheless significantly extends the responsibilities of directors and officers. Specifically, further extension of director's civil and criminal liability to financial services and products regulation in the *Corporations Act*.[214] Extension of liability to subjective, ill-defined criteria would further add to uncertainty, with an additional best interest duty to customers, and further accessorial liability for market outcomes risks. It contradicts previous reform,[215] and legal compliance with subjective opinion would be problematic.[216] It is further

[209] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Interim Report*, above n 135.
[210] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 63.
[211] Greg Tanzer, 'The importance of culture to improving conduct within the financial industry' (Speech delivered at the Thomson Reuters' Third Australian Regulatory Summit, Sydney, 27 May 2015).
[212] *Criminal Code Act 1995* (Cth) pt 2.5.
[213] Greg Medcraft, 'Corporate culture and corporate regulation' (Speech delivered at the Law Council of Australia Seminar, Melbourne, 20 November 2015).
[214] *Corporations Act 2001* (Cth) ch 7.
[215] *Personal Liability for Corporate Fault Reform Act 2012* (Cth).
[216] John HC Colvin and James Argent, 'Corporate and personal liability for culture in corporations' (2016) 34 *Companies and Securities Law Journal* 30, 39.

evidence of statutory intervention into fiduciary principles without elimination of the reasons for this intervention. A necessary policy objective, but consistently wrong solution.

14. DIRECTORS AND TRUSTEE DIRECTORS — STRATEGIC LEADERSHIP OR BONDAGE?

The only certainty for directors, trustees, and trustee directors is further uncertainty. Corporate governance reform of NBFEs is a priority, especially as the NBFE sector consolidates with resulting concentration of systemic risk.

Inconsistency directly influences matters of great importance to directors including insurance and indemnities, content of board papers[217] and access to entity information. Rights of access to information is mainly conferred for practical purposes by the general law in addition to statutory rights. Directors cannot rely for their defence on their management or on third parties, including auditors, or on the Business Judgment Rule,[218] which in any event does not apply to entities regulated under the *SIS Act*, *Fair Work (Registered Organisations) Amendment Act* or retail financial advice. Further, the law as to whom duty is owed is evolving. Presently in MIS, the director's duty is to the company as RE and additionally a best interest duty to the members. In superannuation entities, the duty is to the trustee company, but has evolved directors also having a duty to the member directly. A nexus between director and member. Additional statutory duties for directors and trustees of superannuation entities result in directors having outcomes liability for market-linked, inflation, post-tax, and longevity outcomes. These risks are largely outside of the control of the director, however well informed.

Cooper admits that the present *SIS Act* is complex for both APRA regulated trustees and the SMSF sector and recommended a rewrite of it. Cooper proposes that there should be clarity about duties owed by trustee directors and the standard of competence they should possess and exercise. This combination of complexity and inherent differences between sectors can lead to regulators providing different interpretations, regulatory approaches, and responses.[219]

In Australia, most directors are drawn from the general community, some as employer and employee representatives, including from registered organisations. Those from the latter are used to lesser statutory standards than those experienced with the *Corporations Act* and the *SIS Act*. Many of these appointments, whilst doubtless honourable and properly intentioned, are not professional directors and there would be few who know of or comprehend the different law applying to the basic obligation

[217] For superannuation entities, these need to include detailed reporting of management issues.
[218] *Corporations Act 2001* (Cth) s 180(2).
[219] Cooper, above n 51, 327.

of best interest. The only mandatory education proposed (with the ATO having enforcement power) is for SMSF trustees who have breached the *SIS Act*.

Shifting policy sands, constantly changing regulation, regular judicial review, and subsequent statutory responses make it extraordinarily difficult for a director, a director of a corporate trustee, or a trustee in person, to either understand the law, or to properly discharge their duties. The Cooper requirements to be non-associated and the additional statutory duties in respect of conflicts of interest and higher standards of competency is likely to result in a smaller pool of eligible, suitably qualified trustee directors being available for board appointments. There is no Profession of Director in Australia from which to draw.[220]

[220] This is not the case in other jurisdictions (eg the UK), which require directors of collective investment schemes and pension schemes to undertake professional accreditation and development.

15. CONCLUSION: FOUR THEMES IN LAW REFORM FOR A GLOBALISED WORLD

Strategy and tactics

Whilst Australia has benefited from its Twin Peaks (now Triple Peaks) market based regulatory architecture, its regulation of financial products and financial services requires substantive strategic reform supported by tactical interventions. This includes law reform and reforms designed to enhance productivity in the economy. Without substantive reform, there will not be adequate remedy of the systemic deficiencies in regulation nor of their cyclical manifestations which harm productivity. Present responses to public anger are mainly tactical in nature. That anger is based upon flawed community expectations and a belated understanding that what market participants do can be different from what those participants are expected to do. There is not, in Australia, sufficient understanding by the investing public of competing policy approaches or the benefits that the market based approach has brought to the community. Hardship driven policy change could destroy the economic benefits of an entrepreneurial society.

Reform requires significant elapsed time, probably a decade, and it must be sequenced. Strategic reform requires acceptance and implementation by the various stakeholder groups. Tactical reforms can be imposed legislatively. The effectiveness and stability generated by prudential supervision needs to be embedded as a governance value system — a culture — within the non-prudentially regulated NBFE sector. Successful implementation aligns interest of provider and consumer: it also changes the role of the regulators: they become educators, supervisors. A healthy culture results in enforcement becoming a last resort. 'The answer to cultural shortcomings is developing high standards of professionalism and excellence'.[221]

The former Corporate Law Economic Reform Program (CLERP) of 1997 provides a precedent for a series of strategic and tactical reforms which better implement Australia's market based regulatory system and enhance its national productivity. Rather than change the regulatory architecture, reform should be directed at much better implementation of that architecture to eliminate its systemic deficiencies and cyclical manifestations. However, this is not as simple as some suggest.[222] Australia requires more than incremental change to a failing system. This thesis proposes four law reform themes, implemented by four teams reporting to a senior ministerial level special purpose financial

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[221] Colvin and Argent, above n 216, 47.
[222] Andrew Godwin and Ian Ramsay, 'Twin Peaks - the legal and regulatory anatomy of Australia's system of financial regulation' (2015) 26 *Journal of Banking and Finance Law and Practice* 267.

consumer-centric Reference Group. That reflects the magnitude of the task ahead, strategic in scope and objective, each theme supported by tactical statutory interventions.

The four reform themes are: Re-establishment of trust in the investment chain based on fiduciary obligation; Related party transactions, value shifting through tunnelling and conflicts of interest; Architecture for implementation at the financial consumer level — financial planning and wealth management as a profession; and Market conduct regulation for the 21st century (including ASIC reform). To improve Australia's position as a world financial centre, these reform themes are to be given tactical support in disclosure, NBFE corporate governance, MIS, and director and trustees competencies.

The benefits of efficiently designed and implemented reform include increased capital availability for Australian industry, less systemic risk for investors, increased financial literacy and knowledge for investors, and harmonisation of Australian financial regulation with international norms. The latter opens the way for financial product portability internationally and more investment options for Australian investors. These reforms open the way for a true private banking industry in Australia. They provide the basis for veracity in public policy uncorrupted by sectional and political influence.

CHAPTER 2: TWIN PEAKS, THE ASCENT INTO UNCERTAINTY

The regulation of financial services and financial products in Australia, 1981-2018

1. INTRODUCTION

This chapter traces the twin themes of market conduct regulation of Non-Bank Financial Entities (NBFEs) and prudential supervision of superannuation savings which reflect Australia's changing global circumstances and opportunities. On one hand, law reform to encourage entrepreneurship, on the other, compromised implementation leading to large financial losses, deep seated community anger, demands for revenge, and significant statutory responses. Despite this, intermittent but persistent pressures continue to direct superannuation savings to specific industry sectors. The tensions between entrepreneurial need and regulatory compliance is a recurring theme. This chapter identifies solutions.

1.1 A nation in transition

The story of modern Australia is one of political and economic transition. British entry into the then Common Market (now European Union) and withdrawal from military and imperial obligations 'east of Suez' in 1972 triggered the need for Australia to recognise that its place and role in the world was changing. Australia required economic independence. The complacency and prosperity of previous decades was to be challenged by an urgent need to diversify and modernise the industrial and economic base of the nation. The economy had been tightly controlled. It compromised mainly low value adding manufacturing industry protected by tariff barriers, infrastructure built primarily by government fiat, agriculture largely low value adding, and a nascent commodities oriented export mining sector.

This was not the economy required for prosperity in a changed and globalising world. Previous periods of prosperity had been built on imperial preference and bountiful resources for a tiny population. An increasingly sclerotic economy prompted Singapore's Prime Minister Lee Kuan Yew's aphorism: the 'White trash of Asia'.[1] In 1986, Australia's own treasurer, Paul Keating warned of Australia becoming a 'Banana Republic'.[2] There was no recognisable venture capital industry. Business and consumer credit was constrained and expensive, and skilled people became an export:

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[1] Graeme Dobell, Interview with Lee Kuan Yew, Prime Minister of Singapore (ABC AM Radio, 18 April 1995) <www.aspistrategist.org.au/lee-kian-yew-and oz-2/>.

[2] Tom Conley, 'Revisiting the banana republic and other familiar destinations', *The Conversation* (June 13 2013) <http://the conversation.com/revisiting-the-banana-republic-and-other-familiar-destinations>.

a brain drain of its best talent. Australia was home to a small coterie of solid teaching universities, but there was no substantial research university building technological innovation into entrepreneurial global enterprises.

The entry of foreign banks from 1984 not only led to increased competition, perceived and real, but also to new consumer and business financial products. Importantly, these foreign banks brought international business culture and skills to an oligopolistic banking sector. A nascent venture capital industry developed using Managed Investment Companies (MICs) as licensed tax preferred vehicles. A new awareness of what is possible led to equities market investment in university research projects, technical innovation, and the establishment and growth of entrepreneurial technically based business enterprises. This facilitated the renewal Australian manufacturing, some manufacturers becoming global brands with internationally significant market capitalisations. Many universities created spin off entities specifically to capitalise on newfound financing freedoms. Public sector agencies, including the Commonwealth Scientific Industrial Research Organisation (CSIRO) followed. Reform generated excitement and enabled entrepreneurship. This was the era of the 'Industry Plan' designed to modernise sectors of the economy. It was the era of Science and Technology Ministers at the Commonwealth and in the States wanting to emulate Wilson's 'White Hot Technological Revolution'[3] of 1960s United Kingdom, albeit two decades later. More kindly, it was the emulation of Stanford University and Silicon Valley, the MIT corridor in Boston, Utah Innovation Foundation, and IC^2 at University of Texas Austin which provided the role models for what could be achieved.

Reform of the Australian financial system and its many consequences was followed by recession in 1991. The Green Shoots of recovery from approximately 1994 created the conditions for the second generation of NBFE entrants able to capitalise on the reform agenda. Many in the first, 1980s generation, were destroyed or damaged by the recession and its attendant high nominal and real interest rates. This second generation had much greater scope and scale in consumer, business and industrial finance. Licensed MICs were replaced by tax preferred Pooled Development Funds (PDF), and later, Industry Innovation Funds (IIF) with additional tax preferred support for research and development investments. This tax preferred support created a new NBFE industry in leveraged R&D schemes (R&D Syndications) promoted by several major financial institutions, the leverage being over valuations of core technology which were often specious and subject to later regulatory review and litigation.

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[3] Harold Wilson, 'Labour's Plan for Science' (Speech delivered at the Annual Conference, Labour Party, Scarborough, October 1 1963).

Subsequently the NBFE sector has grown enormously across most asset classes. Today Australia has a recognised funds management sector, parts of which operate internationally. Not without tears, not without reputational damage, and in need of betterment. The reform process is far from complete with attendant opportunity costs.

2. THE AGE OF DEREGULATION AND ENTREPRENEURSHIP (1981–2001)

2.1 Reform for a globalised world

Stimulation of the economy required the release of the animal spirits of entrepreneurship. Law reform was designed to deregulate the financial system. In the 1970s, the Australian financial system was tightly controlled. Control stemmed from the recommendations of the Napier Royal Commission of 1937. Tight control of the banking system resulted in the growth of NBFIs to satisfy unmet demand for capital, some of which were owned by the banks. Colloquially, Shadow Banking. This paradigm remains part of the system today, hugely expanded into NBFEs, including investment banks, collective investment schemes, and superannuation entities. There was a disconnection between entrepreneurial demand for capital and the institutional willingness to provide it, although there are records dating to 1882 where banks did provide start-up capital for mining enterprises.

Initial reform of the capital markets commenced in 1981[4] allowing Australia to better satisfy the entrepreneurial qualities of its people by facilitating access to capital. Then, NBFEs were not of the size, complexity and commercial importance they subsequently became. Neither were trusts (Managed Investment Schemes [MIS], for example) generally used as trading enterprises.

2.2 Steps towards financial deregulation in Australia

Campbell believed that 'less intrusive regulation and greater competition would lead to greater efficiency in the financial system and that consumers would benefit from these changes'.[5] Deregulating the Australian financial system included: modification of the tools of macroeconomic management; removal of controls on interest rates and portfolio composition; strengthen and preserve financial system stability; and removing barriers to entry (including the entry of foreign banks), mostly implemented by mid-1996. Campbell was the beginning of the end of post-war era of tight constraints over Australian capital markets. It facilitated deepening and growth of the Australian economy.

Martin in 1984 specifically considered these recent developments 'including regulation of [NBFIs]' and those recommendations of Campbell designed to improve efficiency and stability of the Australian financial system.[6] Martin largely validated Campbell. Specifically, that Australia create a

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[4] Sir Keith Campbell, *Committee of Inquiry into the Australian Financial System* (Australian Government Publishing Service, Cat No 8104251, Canberra, 1981) ['Campbell' or 'Campbell Report'].

[5] Phil Hanratty, 'The Wallis Report on the Australian Financial System: Summary and Critique' (Research Paper No 16, Department of the Parliamentary Library Information and Research Services, 1997) 21.

[6] G C Lim, 'The Martin Report' [1984] 2 *The Australian Economic Review* 26.

desirable financial system that is efficient and competitive. Regulations impinging on that objective are undesirable and should be removed. It ‘did not see a need to extend controls over non-bank financial institutions’.[7] Its preference was for market oriented policies rather than regulatory intervention. Martin noted that ‘there is no present need to extend prudential supervision to non-bank deposit taking institutions’.[8] Campbell and Martin ‘argued very strongly for government [prudential] intervention’[9] to deposit taking banking institutions.

2.3 Regulating poor behaviour

Where economic freedom is allowed to flourish, so financial abuses inevitably follow. After the stock market crash in 1987, it was feared that Campbell inspired deregulation had gone too far. An alternative approach was sought to ensure that bank customers received fair treatment. Martin in 1991[10] concluded that the banks should be required to establish a formal system of self-regulation based on a government approved Code of Banking Practice.

Martin cited the financial impracticality of laws and Courts to resolve bank disputes by all but a few of Australia’s wealthiest people. The code was therefore introduced as an alternative to Courts with cheap, speedy, fair and accessible alternative for customers to resolve complaints justly. This time, Martin was primarily concerned with the asymmetry of financial resources between large financial institutions and their customers. He did not research NBFEs, but similar dynamics are evident today in the asymmetries between them and their investors.

Martin expressed concern for individuals and small businesses, giving particular attention to issues relating to the adequacy of means of redress available to customers in cases of dispute with their bank. It emphasised significant power imbalances between customers and banks, echoes of which recur in many subsequent cases. Financial institutions control relevant information and documentation and have been able to vary contracts unilaterally. They have access to specialist legal advice and financial resources to pursue disputes to the end with little incentive for banks to settle a dispute, unlike their customers, even if the bank would be likely to lose. They may even create a favourable precedent. Further, institutions have inherent faith in their internal operating systems and may be reluctant to admit failures in those systems. Their interest lies in resisting claims and outweigh that of an

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[7] Ibid 27.
[8] By implication, no proclamation of the then Part IV of the *Financial Corporations Act 1974* (Cth).
[9] Lim, above n 6, 31.
[10] V E Martin, *Pocket full of change* (Report, Parliamentary Inquiry into the Australian Banking Industry, 1991) [‘Martin’ or ‘Martin Report’].

individual customer in pressing it. They protect a system whereas the customer seeks redress on a one-off basis. Whistleblowers in financial institutions require moral courage and financial resources.

2.4 Towards Twin Peaks – redesign of the regulatory architecture

Campbell and Martin opened the door, their objective being an open, internationally competitive Australian economy. Wallis[11] in 1997 then designed the strategic architecture to enable Australian financial institutions to compete in a globalising world. It resulted in the rapid evolution of financial products and services available to Australian consumers. Wallis essentially led to the financial system in Australia today, its economically important NBFE sector and investment opportunities which may not have otherwise existed. Present day NBFEs have a larger asset base than the Australian banking sector.

Collectively, these reforms were economically Australia's 'Berlin Wall' moment. As that monument to monopoly was destroyed, resulting freedoms produced anticipated and unanticipated outcomes: a temporary real estate boom followed by unanticipated sober realisation that there was much else to be done, taking many decades. Similarly, unanticipated outcomes occurred in Australia under completely different circumstances. Substantive reform is akin to throwing rocks in a lake which generate ripples. One ripple, or unanticipated outcome being the imbalance of power between capital providers and their clients. The unkind may say 'victims', sentiments which resonate strongly in 2018.[12] The volatility of equities markets in 1987, high nominal interest rates, the resulting recession of 1990–91 and its aftermath led to questioning of the reform agenda, but it was not the causal factor.

Wallis[13] designed a new financial system based on market conduct principles. Compulsory superannuation from 1992,[14] hitherto the preserve of public sector employees and those in corporate superannuation funds. Previously, there were no industry superannuation funds, retail funds only receiving contributions on a voluntary basis. The superannuation reforms complimented Wallis. They have resulted in Australia having the fourth largest pool of retirement savings in the world, but still insufficient to reduce tax demand on future taxpayers. The majority of the working population remain reliant on a government aged pension. However, there is no sovereign wealth fund or national provident fund to provide for those pension expenditures in later years with the exception of the

[11] S Wallis, *Australian Financial System Inquiry Final Report*, (Canberra, Commonwealth of Australia Australian Government Publishing Service, March 1997) ['Wallis' or 'Wallis Report'].
[12] Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (2018) yet to report.
[13] Ibid.
[14] *Superannuation Guarantee (Administration) Act 1992* (Cth).

[Commonwealth] Future Fund (from 2006) for commonwealth public servants. In 2018, government and the beneficiaries still have to address the results of this policy.

The Wallis objective was to redesign the regulatory institutional architecture and modernise financial system regulation in response to changing market and economic conditions whilst preserving safety and stability of the financial system.[15] This reconfiguration also to enable customer stakeholders to access financial services on the most commercially favourable basis, improve efficiency and cost effectiveness through enhanced competition and contestability, with no compromises on financial system integrity, stability, and safety. These reforms required legislative intervention for their implementation by the Corporate Law Economic Reform Program (CLERP). Wallis sought to 'harmonis[ing]e the regulation of collective investments and public offer superannuation funds'.[16]

Wallis considered that an unintended consequence of Campbell and Martin 'has been an increase in the extent and complexity of prudential and consumer protection regulation'.[17] Deregulation was intended to yield benefits to consumers of financial products. Wallis concluded that: product choices have widened since the early 1980s, the quality of financial products had improved, the major exception being deficiencies in implementation of 'the provision of information and advice'.[18] But,

> [t]here is some evidence that consumers are frustrated by limited product knowledge, inability to make meaningful comparisons amongst products, and deficiencies in the information and advice supplied by vendors.[19]

These are deficiencies in disclosure.

Wallis redesigned Australia's regulatory architecture. It replaced four regulatory agencies[20] with a newly mandated Reserve Bank (RBA),[21] the Australian Prudential Regulation Commission (APRC),[22] and the Corporations and Financial Services Commission (CFSC).[23] CFSC assumed consumer protection responsibility.[24]

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[15] Ian R Harper, 'The Wallis Report: An Overview' (1997) 30 (3) *The Australian Economic Review* 288; Hanratty, above n 5, 21.
[16] Ibid 297.
[17] Ibid 290
[18] Ibid.
[19] Ibid.
[20] Reserve Bank, The Australian Financial Institutions Commission, Insurance and Superannuation Commission, Australian Securities Commission.
[21] Restricted to the conduct of monetary policy, financial system stability, and payment system integrity.
[22] APRC, now the Australian Prudential Regulation Authority (APRA).
[23] CFSC, now the Australian Securities and Investments Commission (ASIC).
[24] Now shared with the Australian Competition and Consumer Commission (ACCC).

This architecture is the Twin Peaks (really 'four peaks', if including the Reserve Bank) model with Australia an early adopter. It separated market conduct regulation from prudential supervision, and from the financial stability mandate of the RBA. APRC was to be the single economy wide prudential regulator for the entire financial system, CFSC the disclosure regulator requiring participants act with integrity in an environment of mutual trust with adequate disclosure to facilitate informed judgments. This Twin Peaks model intended common standards across disparate NBFE sectors. Other countries subsequently adopted it.[25]

Wallis acknowledged a regulatory system based on disclosure had inherent information asymmetries. Market failures may require government intervention, graduated according to need. He also acknowledged that regulatory reform can improve the performance of the managed funds industry. The Law Matters.

Wallis was an early proponent of employees and superannuation fund members having a greater choice of fund. Regulation of collective investments[26] and public offer superannuation funds should be harmonised, an objective not yet achieved acknowledging that prudential supervision implies moral hazard.

Wallis, like Campbell, proposed strategic reform. The implementation of it evolved the Australian financial system. It was not without its critics: there were considerable concerns about the replacement of the dual party trustee system with a single licensing regime and its lack of a mandatory requirement for a custodian (balanced by limited statutory capital adequacy).[27] Others viewed it as a strength of the new system. Some of the dissent was self-interested and conflicted. So there was no consistent, integrated set of alternative policy. Dissent included retention of consumer protection of financial products and services within the ACCC, responsibility for prudential regulation being mandated to the APRC, its separation from the RBA, and the evolution from financial institution

[25] Netherlands, Qatar, Switzerland, Spain, for example; see generally Andrew D Schmulow, 'The four methods of financial system regulation: An international comparative survey' (2015) 26 *Journal of Banking and Finance Law and Practice* 151, 160.
[26] In Australia, managed investments.
[27] Phil Hanratty, 'The Wallis Report on the Australian Financial System: Summary and Critique' (Research Paper No 16, Department of the Parliamentary Library Information and Research Services, 1997) 23–25; Alan Jessup, *Killing Bambi – Improving the effectiveness and efficiency of the legal and regulatory framework for protection of retail investors investing in collective investment schemes* (SJD thesis application to University of Sydney, 2012); Grant Moodie and Ian Ramsay, *Managed Investment Schemes: An Industry Report* (Report, The University of Melbourne, 2003) 78. For an ex post analysis, see generally Kevin Davis, 'The Australian Financial System in the 2000s: Dodging the Bullet' in H Gerard and J Kearns (eds), *The Australian Economy in the 2000s* (Reserve Bank of Australia, 2011) 313; Tom Valentine, 'The Regulation of Investments' (2010) 27(3) *Economic Papers: A journal of applied economics and policy* 272, 274.

community service obligations to a market based environment including fees and charges. Reform created opposition. Abandonment of explicit deposit insurance for retail bank customers commonly used in other jurisdictions needed to be reinstated in 2009 although it did not extend to most NBFEs.

2.5 Twin Peaks 1: Prudential Regulation: modernising superannuation savings

The introduction of the *Superannuation Industry (Supervision) Act*[28] used market mechanisms of trustees, fund managers, and other NBFEs in the investment chain to modernise and promulgate superannuation across the community. Superannuation became a right, not a privilege.[29] It fostered further growth of not-for-profit industry funds. Savings became compulsory with implementation outsourced to the private sector. It considered that 'increased education of fund members, trustees, and other industry participants will assist in focussing attention on the prudential management of superannuation funds.'[30] The *SIS Act* is the statutory framework for APRA regulated superannuation entities. It codified trustee duties, then existing in general law:[31] 'it supersedes the existing common law to the extent that the code and the common law conflict'.[32] This codification represented a

> major change to the legal basis for the regulation and prudential supervision of superannuation funds in this country. To date, superannuation funds have relied largely on trust law and common law precedents … there have been relatively few statutory requirements …[33] The legislation largely overturns the existing legal basis for superannuation fund operations and replaces it with the type of black letter law that now characterises the new corporations law that has been introduced with mixed success.[34]

The policy aim was to codify the duty which trustees owe to beneficiaries,[35] without it discouraging people from acting as a trustee. This was the reason for eliminating the experienced in business test[36] which would have had the practical impact of eliminating many candidates for board appointments.

[28] *Superannuation Industry (Supervision) Act 1993* (Cth) ['*SIS Act*'].
[29] Kevin Yi Liu, *Australian Superannuation: Operational Structure, Investment Performance and Trustee Governance* (PhD Thesis, The University of Sydney, 2013) 12.
[30] Commonwealth, Hansard, House of Representatives, Superannuation Industry (Supervision) Bill 27 May 1993 1101, 3–5 (Paul Keating).
[31] *Superannuation Industry (Supervision) Act 1993* (Cth) s 52.
[32] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [294] (S A Forgie V-P and B H Pascoe).
[33] Ibid [308] (S A Forgie V-P and B H Pascoe).
[34] Ibid.
[35] Donald Duval, 'The Objectives of the Superannuation Supervisory Legislation' (Paper presented at the Conference of the Superannuation Committee of the Law Council of Australia, 1994).
[36] *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(2)(b).

Importantly for directors and trustees, the *SIS Act* has a tension between the generation of investment return using market mechanisms and the prudential management of the fund.

> The trustee will need to exhibit some degree of entrepreneurial flair that could, perhaps be more conservatively described as business acumen. That is implicitly encouraged because the Government expressly recognised that good investment returns are critical to provide an adequate retirement income and restrictions placed on investments would lead to poorer returns. Business acumen also has its place in the prudential management of the fund. Without it, the fund might never grow and prosper. That would not be in the interests of the beneficiaries.[37]

These legislative changes markedly affected directors as well as trustees, including 'specific obligations on responsible entities [REs] which are individual trustees, and directors of companies which act as trustees'.[38] Inconsistencies abound. For instance, the *SIS Act* codified the 'ordinary prudent person'[39] test whilst the general law referred to 'an ordinary prudent person of business'.[40] It refers to the duty 'in relation to all matters affecting the entity'[41] whilst the general law refers to 'managing trust affairs'.[42] These inconsistencies and uncertainties in governance that subsequently arise were reported in 2010,[43] and 2014[44] suggesting a rewrite of the *SIS Act*.[45]

Trustee duties in the general law developed under judicial supervision and extended into administrative law. These duties were not developed in the

> context of supervision by a regulatory authority. What Parliament has done is to place standards that have their genesis in the general law, in s 52(2) and from there into the Trust Deed …[46] obligations imposed on a superannuation entity in relation to the members be imposed individually on each member of the board of management of that entity,[47]

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[37] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [530] (S A Forgie V-P, and B H Pascoe).
[38] Commonwealth, Hansard, House of Representatives, Superannuation Industry (Supervision) Bill 27 May 1993 1101, 3–5 (Paul Keating).
[39] *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(2)(b).
[40] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [325] (S A Forgie V-P and B H Pascoe).
[41] *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(2)(b).
[42] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [325] (S A Forgie V-P and B H Pascoe).
[43] Jeremy Cooper, *Review of the Governance, Efficiency, Structure, and operation of Australia's Superannuation System* (Commonwealth of Australia, 30 June 2010) ['Cooper'].
[44] David Murray, *Financial System Final Report* (Australia Treasury, 2014) ['Murray'].
[45] Cooper, above n 43, rec 10.18.
[46] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [327] (S A Forgie V-P and B H Pascoe).
[47] Ibid [322] (S A Forgie V-P and B H Pascoe.

a situation not then prevailing in general law, now enacted in the legislation.[48]

The *SIS Act* was not a restatement of the existing law relating to regulated superannuation funds. 'Supervision' means much more. It intended codification 'in clear statutory terms'[49] of trustee fiduciary duties. This arose from a belief that:

> principles of trust law are poorly understood. They are also capable of being diluted by specific provisions placed in trust deeds ... [d]eeds or other instruments constituting superannuation schemes would not be able to derogate from their obligations[50] … we have observed that a number of trust deeds gave effective power to a party other than a trustee.[51]

2.6 Twin Peaks 2: Market Conduct Regulation: Corporate Law Economic Reform Program (CLERP)

CLERP[52] gave legislative effect to Campbell and Wallis financial efficiency and stability objectives. For NBFEs, legislation included the *Managed Investments Act*[53] and the *Financial Services Reform Act*.[54] The *Managed Investments Act* marked a radical shift in the policy of regulating collective investment schemes.[55]

Efficiency objectives included facilitation of corporate fundraising, improvements to accounting standards (including international harmonisation), streamlining takeover rules, facilitation of electronic commerce, enabling comparable regulation of financial products, disclosure standards to enable comparisons between financial products, and licensing of intermediaries. Stability objectives included removing legal uncertainties for directors (and the introduction of a business judgment rule),[56] allow the delegation of director functions to other persons, reliance on the information and advice provided by that person, clarification of directors' indemnities and penalties for breach of duty.

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48 *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(8).
49 *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [313] (S A Forgie V-P and B H Pascoe).
50 Ibid [313] (S A Forgie V-P and B H Pascoe).
51 Ibid [311] (S A Forgie V-P and B H Pascoe); Duval, above n 35.
52 CLERP, Policy Reforms 1998, Commonwealth of Australia; *Corporate Law Economic Reform Program Act 1999* (Cth).
53 *Managed Investments Act 1998* (Cth) Now Chapter 5.C of the *Corporations Act 2001* (Cth).
54 *Financial Services Reform Act 2001* (Cth).
55 Grant Moodie and Ian Ramsay, *Managed Investment Schemes: An Industry Report* (Report, The University of Melbourne, 2003); Australian Law Reform Commission, *Collective Investments: Other People's Money* (Report No 65, 1993).
56 Australian Institute of Company Directors, Submission to Joe Hockey, Parliament of Australia, *The process of Law Reform CLERP s 181 and s 189 and the Business Judgment Rule*, 17th March 2000.

2.6.1 Statutory Modernisation: *Managed Investments Act*[57] and *Financial Services Reform Act*[58]

The law relating to prescribed interests[59] (prescribed interests dual party system) was replaced on 1 July 1998 by the *Managed Investments Act*. The former system separated the roles of the manager (required to hold a securities dealer licence) and the trustee (required to be an approved trustee). Offer of prescribed interests were required to have an approved deed (unless an excluded offer) containing specific covenants. The separation of manager and trustee was regarded by some as unwieldy and inefficient, possibly anti-entrepreneurial. The *Managed Investments Act* facilitated the development of funds management companies across a range of asset classes offering a range of managed investment products and structures.[60] The objective was to facilitate efficiency and safety by ensuring there was a single point of responsibility to avoid blame shifting between trustee and scheme operator. An unintended consequence was loss of revenue in the trustee and custody sector, both reliant on scale and information technology infrastructure.

The new law replaced prescribed interests with an interest in a Managed Investment Scheme (MIS), requiring registration with the ASIC if it had more than 20 members or was promoted by a person in the business of promoting such schemes. A single RE replaced the separation of powers of manager/promoter and trustee. REs were required to be public companies, hold an AFSL, have a compliance plan (audited annually), with fund raising subject to prospectus provisions. All MIS property was to be held separately and be clearly identified. Transitional arrangements provided prescribed interests be converted to interests in a MIS.

The economic intent of the new law was to unleash investment opportunities and their development potential. The risk lay in eliminating the separation of powers into a single RE structure, albeit subject to their Constitution and Compliance Plans, but nonetheless reliant on the Wallis principles of disclosure, advice, and investor financial literacy. Despite the public company requirement, REs required prudential capacity was minimal. Consequently, many were undercapitalised to properly fulfil their obligations.

The *Financial Services Reform Act* ('*FSR Act*') introduced a single licensing regime for financial products, a single regime for regulating financial services (investment advice) and other financial

[57] *Managed Investments Act 1998* (Cth), now Chapter 5C of the *Corporations Act 2001* (Cth).
[58] *Financial Services Reform Act 2001* (Cth).
[59] *Corporations Law* s 9.
[60] Kevin Davis, 'The Australian Financial System in the 2000s: Dodging the Bullet' in H Gerard and J Kearns (eds), *The Australian Economy in the 2000s* (Reserve Bank of Australia, 2011) 313.

intermediation.[61] It imposed disclosure requirements envisaged by Wallis based on efficient markets theory. The *FSR Act* amended the *Corporations Act* in 2002 giving effect to Wallis.

The result was an approach to investor protection in non-prudentially regulated NBFEs based upon disclosure, advice, and investor empowerment through education. This was extended in 2010 with ASIC having responsibility for the regulation and enforcement of a uniform framework for most financial products and financial services providers.

The Turnbull Review[62] of the *Managed Investments Act* in 2001 expressed confidence in its integrity to deliver increased investor protection and ASIC's capacity to fulfil its mandate as regulator of a diverse population of MIS. It proposed tactical legislative amendments designed to remove uncertainty and improve corporate governance standards. Turnbull was critical of the governance responsibilities of compliance committees and compliance plan auditors. It did not examine the need for mandatory custodianship of fund assets nor address the conflicted poacher-gamekeeper problem of eliminating the independent trustee.

2.6.2 Statutory Modernisation: Business Judgment Rule (BJR)

The intent of the business judgment rule was to balance directors' duties and liabilities with the needs of an independent corporation to engage in economic entrepreneurship, and to avoid the evisceration of companies such that none could make serious commercial decisions without the daily approval of lawyers,[63] particularly in respect of disclosure of information and business conduct. The *Corporations Act* s 180(1) seeks to codify general law duty of care, s 180(2) is the BJR, s 180(3) defines business judgment.

The business judgment reform was based on US common law practice[64] which 'creates a clear presumption in favour of directors',[65] but subsequent judicial interpretation provides no meaningful statutory protection of directors under Australian law despite it having a BJR.

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[61] Ibid 313.

[62] M Turnbull, The Australian Government The Treasury, *Review of the Managed Investments Act* (3 December 2001).

[63] Justice Michael Kirby, 'The company director: past, present, and future' (Speech delivered at the Australian Institute of Company Directors, Tasmanian Division, Hobart, 1998); L Law, 'The Business Judgment Rule in Australia: A Reappraisal since the AWA Case' (1997) 15 *Companies and Securities Law Journal* 174.

[64] 'Principles of Corporate Governance: Analysis and Recommendations' (The American Law Institute, 2008).

[65] *ASIC v Rich* [2009] NSWSC 1229 [7261] (Austin J) cited in Jenifer Varzaly, 'Protecting the authority of directors: an empirical analysis of the statutory business judgment rule' (2012) 12 (2) *Journal of Corporate Law Studies* 447.

> A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and equity, in respect of their judgment if they: (a) make the judgment in good faith and for a proper purpose; and (b) do not have a material personal interest in the subject matter of the judgment; and (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and (d) rationally believe that the judgment is in the best interests of the corporation.[66]

The Australian BJR does not apply in insolvency situations with directors and trustees continuing to have personal liability for solvency.[67] This is not the situation in the UK,[68] USA, and Canada. These jurisdictions focus on the importance of disciplined corporate reconstruction to protect value. This task is carried out by Chief Restructuring Officers who have protection from charges of insolvent trading as a result of their jurisdictional business judgment rule, and other protections.

2.6.3 Statutory Modernisation: Personal Liability for Corporate Fault

The recurring tensions between the entrepreneurial objectives of corporations and the risk aversion of their appointed directors were sought to be addressed by the BJR. This important national productivity issue was addressed legislatively again in 2012 by enactment of the *Personal Liability for Corporate Fault Reform Act*[69] and its State cousins. Whilst not in strict chronological order, it illustrates the ongoing interweaving of entrepreneurship facilitation and consumer protection legislation.

Reaction to systemic regulatory and cultural problems in NBFEs should not serve to destroy economic activity or restrict investment choices. The productivity objective is to deliver ‘a nationally consistent and principles-based approach to the imposition of personal criminal liability for directors and other officers as a consequence of a corporate offence’.[70] These principles are intended to apply consistently to all Australian jurisdictions and all agencies within those jurisdictions, administering hundreds of statutes and regulations, including the *Corporations Act* and the *Foreign Acquisitions and Takeovers Act*.

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[66] *Corporations Act 2001* (Cth) s 180(2).
[67] R Langford, ‘The New Statutory Business Judgment Rule: Should it Apply to the Duty to Prevent Insolvent Trading?’ (1998) 16 *Company and Securities Law Journal* 533 cited in John Farrar and Pamela Hanrahan, *Corporate Governance* (LexisNexis Butterworths, 1st ed, 2017) 231.
[68] *Enterprise and Regulatory Reform Act 2013* (UK).
[69] *Personal Liability for Corporate Fault Reform Act 2012* (Cth); *Miscellaneous Acts Amendment (Directors Liability) Act 2012* (NSW).
[70] The Council of Australian Governments Reform Council, *Personal Liability for Corporate Fault-Guidelines for applying the COAG Principles* (2009).

This legislation and its state counterparts sought to distinguish between direct personal involvement in malfeasance rather than criminal liability as a consequence of a corporation having committed an offence, reflecting the reality of many directors not working in executive roles by removing personal criminal liability for corporate malfeasance unless there is knowing assistance. Australian general law follows *Barnes v Addy* principles of knowing assistance for breaches of fiduciary duty.[71] Where the director or officer: knows of the offence, was involved by encouragement or assistance in the offence, or failed to take reasonable steps to prevent the offence through negligence or recklessness, liability remains. The legislation applies only to criminal penalties, elimination or reduction in criminal liability being tempered by considerations of compelling public policy as to harm, including death and injury, environmental damage, financial markets confidence including insolvency, and morally reprehensible conduct. Knowing is not the same as intent. US jurisprudence disregards 'intent' as a defence. 'It is likely that Australian authorities will follow the [US] lead … regardless of whether the illegal/improper transaction[s] were intentional'.[72]

[71] See ch 4, s 2.7.
[72] Email from Stephen Bullow to author (5 August 2016) citing *Crimes Legislation Amendment (Proceeds of Crimes and Other Measures Act 2016* (Cth).

3. THE AGE OF DISQUIET (2002–2009) — FAILURES IN IMPLEMENTATION

3.1 Early results – Safe as Houses?

Financial products often commence their life being only available on a wholesale basis to professional and sophisticated investors. Many, however, including those that rely on leverage (sometimes multiple leverage) find their way to retail and unsophisticated investors through the market mechanism of financial advice and described in lawful disclosure documents. These were all exposed to market linked risks. Mitigation of these risks was to be based on the Wallis principles of disclosure, advice, and investor empowerment through knowledge. However, belief in these market mechanisms proved to be substantially misplaced. The law of the period including corporate governance standards was insufficiently developed to mitigate these investor risks. Judicial intervention provided remedies and develop the law appropriately for a market based regulatory system, a process which continues today.

Campbell, Wallis, and Johnson (in 2010) [73] wanted an Australia competing globally with its peers, an objective only partly achieved. Implementation competencies were far from prosaic. After Ripoll and ASIC's review of agribusiness MIS, both in 2009, the truth dawned on an unbelieving investing public. Not only was the Australian system found to be substandard against its international peers, but ASIC found it necessary to determine whether some MIS were Ponzi schemes. Many had unsound business models and poor corporate governance. Empirical analysis demonstrates a surfeit of systemic failures arising from reliance on market mechanisms of disclosure and advice, undisciplined by an unknowledgeable investing public. Each of the market based mechanisms relied upon by Australia's regulatory system was suffering systemic and cyclical failures.

Johnson remained faithful to the Wallis entrepreneurial objective proposing mechanisms to ameliorate the disquiet. But against a background of increasing failure in the implementation of market conduct mechanisms including in superannuation entities.

Johnson's objective was to facilitate policy to develop Australia as an international financial sector. He follows Wallis principles whilst focussing on their implementation. In many respects, the regulation of NBFEs and their financial products in Australia does not meet international standards. For Australia to develop as an international financial centre facilitating inwards investment and for

[73] Mark Johnson, *Australia as a Regional Financial Centre* (Financial Centre Forum Report, January 2010) ['Johnson'].

the Australian NBFE sector to export its financial products and funds management skills, it needs to adopt global standards.

Inter alia, Johnson's concern was to ensure 'care be taken that any new regulations are clearly necessary … and are implemented efficiently and effectively, avoiding costs to the corporate sector'.[74] Further, 'pressures from overseas for a more comprehensive and global approach to regulation, when combined with Australia's desire to be seen as a good corporate citizen, may result in Australia adopting more regulatory layers which are neither necessary or relevant to our circumstances'.[75] Wallis referred to 'incentive bias' towards excessive regulation accretion. This arises from community expectations of zero failure by governments and their regulators. Incentives are heavily skewed toward eliminating future corporate collapses, and the consequences that flow from them, by further prescriptive regulation, rather than reliance upon the implementation of principles based architecture.

The Johnson approach is to develop mutual recognition principles for financial products and services, as in the EU, Singapore and Hong Kong, but implementation will rely on Australia adopting international standards. These necessarily include the elimination of the single RE model, which, in the eyes of some international institutional funds managers is akin to the poacher being the gamekeeper. Only one of eleven 2010 recommendations have been implemented (the investment manager regime). The mutual recognition objectives and the RE model remain unreformed. Consequently, Australia remains regionally uncompetitive as a financial centre.

3.2 Failures in governance

HIH failed on 15 March 2001. The HIH Royal Commission[76] into its failure made 61 recommendations, many of which were implemented in the CLERP 9[77] reform process.

Former CLERP amendments[78] which sought to make the *Corporations Law* more certain, had 'precisely the opposite effect'.[79] The Commissioner, made a number of observations: there are gaps in the liability of company officers below board level; many of the undesirable practices within HIH

[74] Ibid 81.
[75] Ibid.
[76] Commonwealth, HIH Royal Commission, *The Failure of HIH Insurance Final Report* (April 2003) (Commissoner Owen).
[77] *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth).
[78] In March 2000.
[79] R A St John, *Corporate duties below board level* (Report, Australian Government Corporations and Market Advisory Committee, April 2006) app 2, 92.

were undertaken by managers, not directors; in larger companies, many decisions are made by management without reference to the board and on a collegiate basis; current law on management liability is unclear and enforcement of governance standards can be ineffective; corporate functions performed by non-employees may not be subject to the *Corporations Act* duty obligations; March 2000 CLERP amendments to statutory duties may have resulted in undesirable conduct; and that duties of executives within a corporate structure require clarification.[80]

Whilst there were a number of causes of the failure of HIH,[81] deficiencies in corporate governance were identified:

> non-executive directors [need] to appreciate their distinctive role to review the performance of management and to take the lead where potential conflicts of interest and duty arise … the benefits of good corporate governance … are more likely to be achieved if the non-executive directors are both independent and seen to be independent.[82]

Legislative reform[83] clarified duties and widened the persons subject to officers' duties and responsibilities.[84] The Commission, not wishing to reduce the liability of directors or shift responsibility to management, nonetheless identified a gap in liability below board level. Directors and trustees necessarily rely on the performance and efficacy of their officers. The statutory definition of the duties of officers of corporations has evolved[85] to include 'any other person who takes part in, or is concerned, in the management of a corporation'.[86] The Commission intended to 'impose duties on all persons performing functions for and on behalf of corporations, whether employees or suppliers of services under contract'.[87] The narrowing of the classes of persons involved as a result of the CLERP 9 reforms[88] was reversed.

> I can see no reason why the legislature would have intended to narrow the class of persons upon whom the liabilities created by s 1309 were imposed. If an employee provides information to a director or

[80] Ibid app 2, 94.
[81] Ibid app 2, 95.
[82] Alan Cameron, 'Lessons from the HIH Royal Commission Report' (Speech delivered at the Australian Institute of Company Directors, 2003) 5 [29].
[83] *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth).
[84] St John, *Corporate duties below board level*, above n 79.
[85] *Companies Code 1981* s 229; *Corporations Law* s 232; 2000 amendments replacing *Corporations Law* s 232 with *Corporations Act 2001* (Cth) ss 180–84.
[86] St John, *Corporate duties below board level,* above n 79, 28.
[87] Ibid 47.
[88] *Corporations Act 2001* (Cth) s 9.

> auditor which he or she knows to be false or misleading, I can see no reason why they should not be held to have contravened the law.[89]

This was intended to reflect the reality of management of a modern corporation being an integrated group exercise involving those who are not directors. 'The uncertain state of the law in this area has been a source of difficulty in my assessment of those cases where there might have been a breach of the law…'[90] 'The law governing the imposition of duties upon persons who act for or on behalf of corporate entities should be clear, simple, and as far as reasonably possible, certain of application'.[91]

Wallis explicitly recommended that the Commonwealth should not be responsible for the financial promises of financial institutions. Nonetheless, Recommendation 61 resulted in the HIH Claims Support Scheme providing approximately AUD640 million in compensation for policy holders. This outcome undermined the objectives of Wallis by creating community expectations of implicit government guarantees of prudentially regulated institutions.[92]

HIH highlighted the jurisdictional differences between the market conduct regulator and the prudential supervisor.[93] ASIC itself had concerns about the level of information sharing being provided by APRA. Legal culpability can be obscured amid jurisdictional confusion. These concerns had been expressed in the cases of the collapse of Tricontinental, State Bank of South Australia,[94] and Trio. In HIH's case, ASIC did have an accounts surveillance program which 'raised no significant issues' in the accounts of either HIH or FAI. However, ASIC measured compliance of the accounts with the then accounting standards, themselves the subject of Commission recommendations.

Strategically, other recommendations resulted in changes to the *APRA Act* and led to governance changes of APRA and the replacement of its non-executive board with an Executive Committee. It commenced the process of evolving from an ex post to an ex ante regulatory posture including enhanced prudential regulation (for insurers), and the development of the PAIRS[95] and SOARS[96] management systems with a revised organisational structure.[97] The management systems measure

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89 St John, *Corporate duties below board level*, above n 79, 55.
90 Commonwealth, HIH Royal Commission, *The Failure of HIH Insurance Final Report* (April 2003) (Commissioner Owen); see also St John, *Corporate duties below board level*, above n 79, 47.
91 Commonwealth, HIH Royal Commission, above n 90; see also St John, *Corporate duties below board level*, above n 79, 95.
92 Davis, above n 60, 312.
93 Cameron, above n 82, 6 [36].
94 Greg McCarthy, 'The HIH Royal Commission and the tangled web of truth' (2001) 60(3) *Australian Journal of Public Administration* 110–12.
95 Probability and Impact Rating System.
96 Supervisory Oversight and Response System.
97 Davis, above n 60, 313.

entity scale rather than propensity to systemic risk.[98] The Commission also recognised that APRA needed to increase its attractiveness to prospective employees, a recurring theme and for ASIC identified in qualitative research.

Governance concerns extend to the regulators. Uhrig[99] proposed that the Commonwealth clarify its expectations of statutory authorities in a statement of its ‘Expectations of Regulators’. ASIC and APRA, as statutory authorities charged with regulatory functions where ‘government is expected to retain control of policy and approval of strategy, are to be governed by an executive management group with an advisory board’.[100] There is no commonality of view on the optimal form of corporate governance for APRA and ASIC. Uhrig confirmed the operational independence of APRA and ASIC under their governance structures.[101] But it is a different proposition to statutory authorities with boards having the power to act, ‘including the freedom to appoint and terminate the CEO’.[102]

3.3 Financial advice

Financial advice is the second tenet of the Wallis reforms. Ripoll[103] in 2009 addressed financial advisers being remunerated by the issuers of financial products product sold under the guise of providing independent advice, commission based payments, the general regulatory environment for financial products and services, potential for conflicts of interest, and the need for appropriate disclosure. In many NBFE collapses, the conflict between interest and duty is manifest. Commonly at this time, a financial adviser may be contractually bound by their employer to recommend only the financial products on the employers Approved Product List, being the products from preferred and sometimes in-house product manufacturers. This practice served the interests of the product issuer, product manufacturer and the adviser. It demonstrably did not serve the interests of the investor.

Ripoll led directly to legislation, the Future of Financial Advice reforms (FoFA).[104] Ripoll recommended the *Corporations Act* be amended to explicitly include a statutory fiduciary duty for

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[98] M Scott Donald, ‘Bank custodians and systemic risk in the Australian superannuation system’ (2015) 26 *Journal of Banking and Finance Law and Practice* 36.
[99] John Uhrig, *Review of the Corporate Governance of Statutory Authorities and Office Holders* (Report, Commonwealth of Australia, Canberra, 2003) ['Uhrig' or 'Uhrig Review'].
[100] John Kalokerinos, 'Corporate governance in statutory authorities: the Uhrig Review' (2004) 56(10) *Keeping Good Companies* 610–612.
[101] Davis, above n 60, 312.
[102] Mick Shadwick, 'Uhrig – A Template for Governance?' (2006) *Public Administration Today* 24.
[103] Parliamentary Joint Committee [PJC] on Corporations and Financial Services, Parliament of Australia, *Inquiry into Financial Services and Products in Australia* (2009) ['Ripoll'].
[104] *Corporations Amendment* (*Future of Financial Advice*) *Act 2012* (Cth); *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth).

financial advisers operating under an AFSL. It be further amended to require more prominent disclosure of interests in financial products materials, disclosure of potential conflicts of interest, and a consultation process with the financial advice industry designed to eliminate payments from financial products manufacturers to financial advisers.

All professionals have a general law duty of reasonable care and skill when giving advice. Most are not fiduciaries. This generated debate as to why a financial planner should have a statutory fiduciary duty at all and whether limitations should be placed on it. ASIC's submission to Ripoll[105] proposed that 'legislation should expressly impose an explicit fiduciary duty on financial advisers requiring them to give priority to their clients' interests ahead of their own'.[106]

Lindgren[107] suggests this is problematic in that an adviser would still be able to have conflicts of interest, but must suppress them and then only to the extent necessary to give priority to the clients' interests. Prioritisation not prohibition. This arises also in the operation of MIS by Responsible Entities.[108] He proposed that:

> all of the legal uncertainties would disappear if the present financial advice industry were to be divided into … independent financial advisers who are not constrained by reference to a list of products and receive no remuneration from product manufacturers, and ... selling agents who … are [not] so constrained and so remunerated.[109]

Subsequent debate has centred on the difference between sales agents and client fee funded financial advisers. The *Corporations Act* defines whether financial advice is general or personal[110] and to whom that advice is provided.[111] Financial advice has also been divided into 'advice about advice', being a fiduciary construct, and 'substantive advice' the statutory construct.[112]

ASIC proposed that 'the Inquiry may need to readdress the balance reached by the Wallis Inquiry between market efficiency and investor protection because ASIC and industry action may not, within

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[105] Ripoll, above n 103.
[106] Kevin Lindgren, 'Fiduciary duty and the Ripoll Report' (2010) 28 *Company and Securities Law Journal* 435.
[107] Ibid 5.
[108] *Corporations Act 2001*(Cth) s 610FC(1)(c).
[109] Lindgren, above n 106, 8.
[110] *Corporations Act 2001*(Cth) s 766B.
[111] *Corporations Act 2001*(Cth) s 761G.
[112] Simone Degeling and Jessica Hudson, 'Fiduciary obligations, financial advisers and FOFA' (2014) 32 *Companies and Securities Law Journal* 527; Simone Degeling and Jessica Hudson, 'Equitable money remedies against advisers who give "advice about advice"' (2015) 33 *Companies and Securities Law Journal* 166.

the current policy settings of the FSR regime, adequately protect retail investors'.[113] In the context of the ASIC submission, this demonstrates frustration with an ex-post regulatory environment.[114] ASIC set out options for regulatory change, proposing statutory fiduciary duty tempered by proposing only a 'fiduciary-style duty'.[115] This is what occurred. ASIC raised the prospect of prudential regulation applying to a greater range of financial products,[116] addressed the adequacy of the reliance upon disclosure,[117] and investor education.[118]

It is likely that face-to-face advice models will become increasingly obsolete for those that cannot afford professional fees. This is the UK experience. Disruptive technology will fill that gap: robo-advice. Australians presently 'unadvised are estimated to hold "dark savings" of $1.9 trillion (slightly less than the superannuation pool) and robo-advice providers have their eyes on the prize.[119] Thus the need for reform becomes ever more pressing. Tactical responses to present business models cannot provide the regulatory environment for the future.

Warning bells were evident in 2009. The Commonwealth responded with the FoFA[120] reforms. They go beyond recommendations of Ripoll and ASIC, but did not extend to a statutory fiduciary duty, only a statutory best interest duty commencing on 1 July 2012.[121] ASIC is also now able to investigate a manager in the absence of a formal complaint. However, the reforms particularly in respect of the payment of commissions to advisers were politicised and there was not bipartisan support for their implementation. The then government wished to address reform of financial advice in the context of the 2014 Cooper Review into superannuation which includes financial advice to fund members.

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[113] Ripoll, above n 103, 11 [26].
[114] Ibid [27].
[115] Ibid 12 tab 2.
[116] Ibid 19 [48].
[117] Ibid 45 [144], 57 [200].
[118] Ibid 75 ch H.
[119] CoreData/StatePlus, *Financial Advice in the Digital Age* (White Paper, December 2015) cited in 'What's on advisers minds in 2016', BT (Newsletter, May 2016).
[120] *Corporations Amendment* (*Future of Financial Advice*) *Act 2012* (Cth); *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth).
[121] The then government did not proceed with amendment of the *Corporations Act* to explicitly include a fiduciary duty for financial advisers. Hanrahan notes that the [Ripoll] recommendations were 'initially adopted in April 2010, but in November 2011, the then responsible Minister moved away from categorising the duty as fiduciary, describing it as a "statutory best interest duty"': Pamela F Hanrahan, 'The relationship between equitable and statutory 'best interest' obligations in financial services law' 7(1) *Journal of Equity* (2013) V. The FSC argued for this outcome. The FPA supported further amendment of *Corporations Act* s 961B(2)(g) to the best interest duty in December 2013 which allowed for 'scaled advice'. See also Cooper, above n 43, Pt One App K 157. Political influence was raised in respect of FoFA and APRA in the qualitative research. See also Ben Butler, 'Can a change of guard fix ASIC's image?', *The Weekend Australian Business* (Sydney), 22–23 March 2018, 29.

Different industry groups took dissenting positions in respect of the Ripoll recommendations.[122] These remain today, leading to uncertainty for the financial planning and wealth management industry, continued contingent risks for their clients and their need to rely on the general law. There has been reform to commission based fees but prioritisation rather than prohibition governs conflicts of interest. These regulations are set out in three lengthy Regulatory Guides[123] which provide substance to judicial concerns of the interpretation of best interest.[124] As yet, there is no case law interpretation.[125]

3.4 Disclosure

Whilst Ripoll focussed on financial advice provided to NBFE investors, Agribusiness Managed Investment Schemes[126] focussed entirely on agribusiness MIS. These are similarly subject to the FSR regime of disclosure, advice, and informed decision making by investors with similar issues arising. ASIC again raised the issue of prudential regulation of managed investment schemes.[127]

Many of these schemes had flawed business models requiring new investors to meet the costs of maintaining the economic interests and retiring the capital of previous investors. ASIC reviewed whether these are illegal investment schemes with Ponzi characteristics[128] concluding that this was not the case. That it required discussion at all raises serious questions about these business models, disclosure, advice provided by conflicted advisers, and the inability of many investors to make informed decisions. It also raised serious questions about the impact of leverage used to purchase these investments, and the quality of advice attached thereto. As a result, far fewer of these schemes are now conceived for the retail investor market.

Recurring systemic issues raised included conflicts of interest, the legal position of the RE, their ownership structures and prudential capital, the regulation of research houses,[129] and the need for

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[122] David Murray, *Financial System Final Report* (Australia Treasury, 2014) App 4 Consultation 291–307 [‘Murray’] lists submissions from 15 industry associations.

[123] ASIC, *Regulatory Guide 244 – Giving information, general advice and scaled advice* (December 2012); ASIC, *Regulatory Guide 246 – Conflicted Remuneration* (March 2013); ASIC, *Regulatory Guide 175 – Licensing: Financial product advisers – Conduct and Disclosure* (October 2013).

[124] *ASIC v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liquidation) (Controllers appointed) (No 3)* [2013] FCA 1342 (12 December 2013) [463] (Murphy J).

[125] *ASIC, in the matter of NSG Services Pty Ltd* [2017] FCA 345 (Moshinsky J).

[126] PJC on Corporations and Financial Services, Parliament of Australia, *Inquiry into Agribusiness Managed Investment Schemes*, July 2009.

[127] Ibid 14 [57].

[128] Ibid 25 [88].

[129] ASIC, Submission to PJC on Corporations and Financial Services, *Inquiry into Agribusiness Managed Investment Schemes*, July 2009, ch J.

regulatory change. No specific proposals were advanced, ASIC making it clear this is a matter for the Commonwealth.

3.5 Financial Literacy

Investor empowerment through education is the third tenet of the Wallis reforms. Literate consumers discipline market participants. ASIC considers financial literacy a vital skill for all consumers.[130] It includes in its definition: mathematical skills, financial understanding, financial competence, and financial responsibility. These skills sets lead to the ability to make informed judgments and take effective financial decisions regarding money.

Research indicates that Australians generally have low levels of financial literacy.[131] The Financial Literacy Foundation (FLF) was established by the Commonwealth to recommend strategic remedies to this problem. The advent of the Compulsory Superannuation Guarantee charge in 1992 to address future retirement income and the means testing of the aged pension requires Australians to be well-equipped to for the financial decisions they must make for their retirement. Many cases demonstrate otherwise. Financial products sold by non-superannuation NBFEs form part of retirement strategy.

In 2008, responsibility for the FLF was transferred to ASIC, this transfer of responsibility being to strengthen policy direction through the use of the regulator.[132] The Financial Literacy Board was established to advise ASIC and the Commonwealth on financial literacy issues.

130 ASIC Report 230, ‘Financial literacy and behavioural change’, March 2011.

131 Sharon Taylor and Suzanne Wagland, 'Financial Literacy: A Review of Government Policy and Initiatives' (2011) 5(2) *Australasian Accounting Business & Finance Journal* 3.

132 Ibid 9.

4. THE AGE OF REACTION (2010–2013)

2010-2013 was a period of Reaction: analysis of the MIS sector, compensatory remedies (St John and Trio Capital), simplification and risk mitigation in the superannuation system (default funds and 'Stronger Super' reforms), and the first large scale international fraud on Australian superannuation (Trio Capital). Forestry MIS highlights the conflicts between economic development objectives, the promoters of forestry MIS investment and those 144 384 investors with aggregate losses of AUD5.8 billion.

4.1 First strategic insights: the end of the beginning

By this time, the Australian media was replete with reporting of cases from aggrieved investors, many of whom had lost their life savings, had no possibility of reconstruction, and faced penury. This author's empirical analysis reveals an increasing number of cases brought for judicial review in the senior courts.[133] The cases demonstrated a tension, a disconnection, between the objectives of the Campbell, Wallis, and Johnson market approaches and their implementation. Is the objective of an entrepreneurial wealth creating society competing with and leading its global peers, compatible with the objective of financial stability and risk mitigation?

Arguably, the first objective has been within reach. For many people the second objective has been a disaster, as the empirical analysis explains.[134] It has also been disastrous for many parts of the economy. It is not possible for more than 1 915 608 individual investor or beneficiary adverse impacts losing or have permanent risk of loss of c AUD52.25 billion without it impacting on the ability of capital markets to finance further productive investment. The cumulative misallocation of capital in aggregate causes lower economic growth — the opportunity cost. Failure of the second objective compromises the first objective. ASIC's review of unlisted property MIS,[135] and subsequent analysis of that NBFE sector demonstrates that more than 50% of these schemes were defunct, illiquid, or are subject to various schemes (including Australian Securities Exchange [ASX] public offerings) which are unlikely to add value for the original investors.

Johnson identifies a possible way out of this conundrum. This knowledge comes from a comparative study of other jurisdictions, including those where market approaches and access to financial products are different. However, before that can be achieved, there must be in Australia a better developed understanding in the investing public of the benefits and deficiencies of competing approaches. The

[133] See below ch 3 tab 3.26.
[134] Author's empirical research, ch 3.
[135] ASIC, 'ASIC review of unlisted property MIS sector' (Media Release, 12-168MR, 17 July 2012).

present danger to this understanding is The Reaction, which seeks to move Australia from its present market based regulatory system to a paternalist statutory system of supervision with consequent losses in investment choices.

4.2 Consequences of deficient implementation of the market reforms

Trio Capital was a multi-function RE, Registrable Superannuation Entity (RSE), and funds manager.[136] This case demonstrated the systemic risks associated with vertical integration in the investment chain. Many RSE licensees are also REs for MIS. Before Trio, a RSE licensee was exempt from the *Corporations Act* RE capitalisation requirement, now reformed by removing that exemption.[137]

The Trio Capital fraud was complex[138] involving two ASIC registered MIS with Trio as RE into which it allocated funds from superannuation entities under its control as RSE. From 2006, trustees, directors, and investors were continuously deceived throughout the operation of the MIS (Astarra Strategic Fund, ASF) about the existence of portfolio assets and their value.[139] Trio received unqualified audit opinions. Governance and compliance reporting did not identify or prevent fraudulent conduct. That was left to an alert non-associated analyst in 2009.[140] The fraud occurred in internationally domiciled hedge funds in which the Australian MIS invested. Neither APRA nor ASIC found evidence in their oversight that there was a fraud occurring. The offshore investment entities reported falsified valuations and fictitious returns to the Australian MIS.[141] These were accepted by the then trustees, directors, and auditors without fully verifying their accuracy.

APRA conducted five prudential reviews of Trio between April 2004 and June 2009.[142] The prudential reviews commenced in 2004. In 2005, a prudential review was held with the management and the trustee executive directors in preparation for the new licensing regime for superannuation funds. Further prudential review occurred in late 2006 involving a review of the administrative systems and investment review with directors and management. These were comprehensive detailed reviews. In August 2008, APRA, in a broad ranging review, examined strategy, risk management,

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[136] See author’s disclosure in Preface.
[137] *Corporations Act 2001*(Cth) s 912A.
[138] *R v Shawn Richard* (2011) NSWSC 866 (Garling J).
[139] Ibid (Garling J) 29; Australian Government The Treasury, *Review of the Trio Capital Fraud and Assessment of the Regulatory Framework* (Report, 2013).
[140] Mr John Hempton, Bronte Capital.
[141] Australian Government The Treasury, *Review of the Trio Capital Fraud*, above n 139, 10.
[142] Senate, PJC, Parliament of Australia, *Inquiry into the collapse of Trio Capital* (2012) 69 [4.22].

governance, investments, and liquidity. In June 2009, a prudential review examined governance, strategy, and investments including valuations and liquidity.[143]

APRA noted that in 2007 and 2008, the Trio funds received unqualified audit opinion and that 'APRA had no reason to believe that the trustee directors were untrustworthy'.[144] However, APRA stated that 'its main focus is on the conduct of trustees, not verification by auditors'.[145] Its responsibility under the *SIS Act* is to 'ensure the superannuation trustees conduct their affairs with appropriate level of fitness and propriety.'

APRA's supervision of Trio Capital was described as Active Supervision meaning on-site visits, examination of investment policies, and concerns about the quality of the trusteeship, but not fraud.[146] The concerns about the quality of the trusteeship were 'not to be of great urgency'.[147] APRA's required governance improvements included the appointment of a majority of independent non-executive directors to the trustee but did not lead to the detection of fraudulent behaviours which continued throughout the life of the MIS.[148] In its 2005 prudential review, APRA were 'satisfied that governance issues (related party arrangements) appeared to be addressed' and 'information requested by APRA was being progressively provided'.[149] In December 2009, APRA issued a 'show cause' letter why Trio should not be suspended or removed as trustee.[150]

The PJC concluded that:

> APRA should not be exonerated for its lack of action in the oversight of *Trio Capital* … is concerned that APRA did not pick up key events … the first prudential review … in June 2004 … [was] not identified as problematic … does raise serious questions about the quality of APRA's prudential reviews. [T]rustee's tardiness … to provide basic valuation information should have raised strong concerns about the trustee [to a risk based regulator],[151] especially one under 'active supervision'.[152]

[143] Evidence to Senate PJC Inquiry into the collapse of Trio Capital, Parliament of Australia, 4 April 2012, Committee Hansard 9; Parliamentary Committee Report 69–70 (Greg Brunner, APRA).
[144] Evidence to Senate PJC Inquiry into the collapse of Trio Capital, above n 143, 70 (Ross Jones).
[145] Senate, PJC, Parliament of Australia, above n 143, 71.
[146] Ibid 74.
[147] Ibid 70.
[148] Australian Government The Treasury, *Review of the Trio Capital Fraud*, above n 139, 11.
[149] Ibid 13.
[150] Senate, PJC, Parliament of Australia, above n 143, 70.
[151] Ibid 74 [4.37]–[4.39].
[152] Ibid 74 [4.28].

The ASIC files remained confidential at the time of this review.[153] At the time, criminal investigations were continuing. ASIC reported that it was not until December 2009 that the directors of the ASF ran that fund for fraudulent purposes.[154] ASIC had previously identified Trio as a high risk hedge fund and were focussed on identification of the existence and valuation of its assets.[155]

ASIC attribute the collapse of Trio to 'the failure of the investment manager, compliance committee, compliance plan audit, the three research houses, custodians, and the advisers to detect outright dishonest conduct'.[156] If ASIC's view is correct then systemic failures facilitated the fraud. The PJC concluded that 'what is required is the more effective enforcement of existing laws'.[157] In one fund (ARP Growth Fund), some investors were induced by a financial adviser to transfer funds from an APRA regulated fund to a MIS in which their self-managed superannuation funds (SMSFs) invested those funds, effectively removing prudential oversight and compensatory mechanisms.[158] Despite these facts, APRA argued that these funds were lost 'due to the failure of Bear Stearns and the severe market movements during the GFC and not due to fraud'.[159] The PJC argue that 'APRA holds this view because it has failed to fully investigate the alternative possibility: there may never have been a contract and the ARP Growth Fund was a fraudulent venture'.[160]

A subsequent Treasury Review found that APRA (and ASIC) carried out their roles and responsibilities appropriately, but that the then board of Trio 'failed to manage and monitor risks associated with overseas investments'.[161] Treasury also correctly expressed concern about consequential losses arising from regulatory intervention. The losses incurred by Trio investors and its clients for whom it provided professional services were not restricted to the direct economic losses in two funds operated fraudulently.[162] Trio regulatory intervention spread to some 26 other MIS and entities in their investment chain which otherwise may have met their commercial objectives.

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[153] Evidence to Senate PJC Inquiry into the collapse of Trio Capital, Parliament of Australia, Canberra, Committee Hansard, 6 September 2011, 10; Parliamentary Committee Report 75 (Glen Unicomb, ASIC).
[154] Ibid.
[155] Evidence to Senate PJC Inquiry into the collapse of Trio Capital, Parliament of Australia, 6th September 2011, Committee Hansard 4; Parliamentary Committee Report 76 (Greg Medcraft, ASIC).
[156] Senate, PJC, Parliament of Australia, above n 143, 89.
[157] Ibid xxii.
[158] Ibid 23.
[159] APRA, Submission No 41 to Senate PJC, *Inquiry into the collapse of Trio Capital* (2012) 5; Parliamentary Report 24.
[160] Senate, PJC, Parliament of Australia, above n 143, 141.
[161] Australian Government The Treasury, *Review of the Trio Capital Fraud*, above n 139, 15.
[162] The Australian Government the Treasury [Richard St John], 'Compensation Arrangements for Consumers of Financial Services: Future of Financial Advice' (Report, April 2012) 38 ['FoFA' or 'St John'].

Trio Capital directly influenced Cooper, St John and FoFA.[163] It directly influenced the evolution of the *SIS Act* and identified statutory reform needs including: prioritisation of fiduciary duty, disclosure, related party transactions, whistleblowing, asset allocation strategy in superannuation, director, trustee and auditor competencies, recruitment, and resourcing, entity capitalisation, and compensation, including for risks associated with the single bridge model for REs. Trio was a clarion call to the systemic risks associated with a large Australian superannuation pool, its international investment diversification, and its attractiveness to malfeasors.

4.3 Towards Stronger Super

Cooper was the end of the beginning for ex post regulation of Australian NBFEs. The Cooper Review[164] is insightful — a strategic examination of the Australian superannuation system with far reaching implications. It analysed the governance and performance of superannuation entities, and, by policy extension, influences NBFEs more widely. Cooper implied that future regulation will significantly enhance expectations of trustees, trustee directors, and other NBFEs in the investment chain. Loss of investor confidence and criticism of ASIC (and APRA) encourages the growth of the SMSF sector implying a lack of confidence in prudentially supervised superannuation. Conflicts of interest and conflicts of objectives were rife, producing 'an unhealthy culture'[165] reflected in the *Stronger Super* legislative reforms.[166]

Australia has a compulsory superannuation sector which has been fully outsourced to the private sector. The Wallis principles that superannuation funds members be treated as rational and informed, supported by general law, are stated to be 'somewhat optimistic' in the development of superannuation architecture.[167] Compulsory savings based on informed investors making rational choices fails to confront the reality of poor financial literacy and lack of 'systemic transparency'.[168]

Superannuation entities (other than SMSFs) are regulated by APRA by the *SIS Act*[169] and are normally governed by a corporate trustee. The vast majority of trustees of APRA regulated funds are companies with a board of trustee-directors. The trustee is the company, not the director.[170] The trustee is

[163] Bill Shorten, 'Comprehensive response to combating superannuation investment fraud' (Media Release, 26 April 2013). See especially Attachment A: Government response to the Parliamentary Joint Committee and Attachment B: Government response to the St John Report, 2013.
[164] Cooper, above n 43.
[165] Senate, PJC, Parliament of Australia, above n 143 ch 2, 3.
[166] Shorten, above n 163.
[167] Ibid pt 1 ch 1, 8.
[168] Ibid ch 1, 14.
[169] *Superannuation Industry (Supervision) Act 1993* (Cth).
[170] Cooper reports there were only five natural person directors of APRA regulated funds at this time.

required to have an RSE license. Section 52(A) of the *SIS Act*[171] redresses the situation where the directors' duty is owed to the company, not the member, and places the director in the position of trustee as a natural person by synchronising the statutory covenants across the trustee company and the director. Further ambiguity arises in respect of when the director is entitled to be indemnified from trust assets and when there is personal liability. There is a conflict between s 197 of the *Corporations Act* and s 56 of the *SIS Act* in respect of the trustees' right of indemnity which would not extend to the director as a natural person without reform of the *Corporations Act*.[172]

There had not been a comprehensive review of the current superannuation system since its inception in 1992. Coopers' 177 recommendations fall into 10 broad categories, many of which were adopted in the *Stronger Super* legislation. The then Commonwealth government rejected the recommendation to remove the mandatory requirements for trustee boards of employer-sponsored funds to have equal representation between employer and employee representatives. It also rejected the recommendation that boards be required to have a critical mass of independent (or non-associated) trustee directors, despite comparison with listed public company corporate governance models and supported by APRA. There is a clear dichotomy between those interests that favour the status quo, and those that favour moving to corporate governance models that are prevalent in the listed public company sector.[173]

Cooper's proposed the concept of trustee-director. 'Trustee directors should not have to collate rules from multiple sources in order to understand their core duties'.[174] These sources include several statutes, general law, and equitable fiduciary principles. Superannuation entities, being a specific type of trust with a corporate trustee provide financial products supplied as a financial service. Proscriptions[175] are mirrored with prescriptive obligations under a different statute,[176] with trustees and directors of industry superannuation fund trustees recruited as part of the equal representation model under another statute[177] that has a different genesis and is from a different culture. Resolving this conundrum requires harmonisation of the different standards of director and trustee director duties embedded in the three statutes.

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171 *Superannuation Industry (Supervision) Act 1993* (Cth) ss 52(A)(6), 52(C)(4). Compilation No 97 1st July 2018.
172 Cooper, above n 43, proposed rec 2.10 pt One, 32.
173 Productivity Commission, *Default Superannuation Funds in Modern Awards* (Report No 60, Final Inquiry Report, Canberra, 2012) 98.
174 Ibid pt 2 ch 2, 46.
175 *Corporations Act 2001*(Cth).
176 *Superannuation Industry (Supervision) Act 1993* (Cth).
177 *Fair Work (Registered Organisations) Act 2009* (Cth).

Prima facie, the concept of trustee-director, with a fixed and easily comprehended rule book would require the elimination of the application of prior general law, and the imposition of statutory fiduciary duty directly between trustee-director and beneficiary, the latter outcome desired by Cooper. Such a concept has not been previously viewed with undiluted pleasure:

> the controversial suggestion … that the duty of directors to their company can itself embrace some level of fiduciary responsibility to the beneficiaries of a trust of which their company is a trustee … is questionable … whether this heralded development in our law is as desirable or necessary one in the trust company context.[178]

Superannuation entity director is now enshrined in Australian law with direct fiduciary obligations to the beneficiary.[179] The result is more complexity: the trustee-director has a best interest duty to the beneficiaries and to the trust company which can conflict.

Cooper's new statutory office of trustee-director included a new set of statutory duties and proposed to reform the structure of trustee boards. All present statutory duties in the *Corporations Act*[180] are to be included with additional duties to those in the present *SIS Act*.[181] The *SIS Act* is to be amended to extend trustee duties to post-taxation consequences of investment decisions, transaction costs and to transparency in asset valuation.[182] These duties considerably extend the liability of trustee directors for investment, community, and environmental outcomes making directors responsible for market risks and social policy. For Choice funds, director liability should a Choice member suffer loss is limited to only those circumstances where the member has chosen a specific course of action. The director is culpable if the Choice options have not been subject to satisfactory 'investment option due diligence, liquidity, and due diligence into the legal structures of underlying investments and especially foreign domiciled entities with no legal presence in Australia'.[183] In effect, an Approved Products List.

Cooper sought to eliminate ambiguities: there should be clarity about duties owed by trustee directors and the standard of competence they should possess and exercise. There has been considerable uncertainty about the meaning of the 'best interest duty' in s 52(2)(c) of the *SIS Act.* The 'regulator's

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[178] *Australian Securities and Investments Commission v As Nominees Limited, Ample Funds Limited, As Securities Pty Ltd and Peter Grenfell Windsor* [1995] FCA 1663 [77]–[78] (Finn J).
[179] Explanatory Memorandum, *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Cth) 1.33.
[180] *Corporations Act 2001* (Cth) ch 2D.
[181] *Superannuation Industry (Supervision) Act 1993* (Cth) s 52.
[182] Cooper, above n 43, pt 1 ch 3, 35.
[183] Ibid pt 1 ch 3, 34.

interpretation (with its apparent focus on outcomes) is arguably at odds with the historical and general law interpretation of various duties and general industry understanding of those duties'.[184] The ordinary prudent person standard becomes a prudent superannuation trustee and directors a superannuation entity director. The fit and proper standard was to be reformed.

Cooper proposed major reform of trustee governance and standards required of trustee directors. Some of these will be additional statutory duties in the *SIS Act* with additional requirements for directors supervising MySuper Default products. There will be a non-binding Code of Trustee Governance designed for more rigorous and transparent governance with enhanced requirements in the management of conflicts of interest.[185] There will be enhanced requirements in transparent disclosure of portfolio assets, which could be problematic for some funds managers. System integrity improvements include RSE-style licensing of fund administration and investment management functions where these are provided by third parties in the investment chain.

Cooper suggests that the *SIS Act* is complex for both APRA regulated trustees and the SMSF sector. This combination of complexity and inherent differences between sectors can lead to regulators providing different interpretations, regulatory approaches, and responses,[186] recommending it be rewritten.[187]

Reform of trustee responsibility extended to MySuper Default funds. All MySuper products will be able to be nominated as default funds in industrial awards approved by Fair Work Australia. Trustees must provide investment advice and separate investment strategies for pre- and post-retirement fund members. Pre-retirement, 'advice is to be available on as broad a range as possible of the financial issues members will face in retirement'.[188] Post-retirement new and specific responsibilities to members include investment strategy not just for the fund itself but also 'for the assets held on behalf of post-retirement members including those set out in the Act[189] and inflation and longevity risk'.[190] The architecture governing MySuper products was a major reform and includes reform of the interface with the industrial award system and the *Fair Work Act*. The reforms to MySuper are designed to commoditise default superannuation funds, eliminate intermediation commissions,

[184] Ibid pt 2 ch 2, 47.
[185] Ibid pt 2 ch 2, 43.
[186] Ibid 327.
[187] Ibid rec 10.18.
[188] Ibid ch 7, 208.
[189] *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(2)(f).
[190] Cooper, above n 43, ch 7, 209.

eliminate intra-entity cross subsidisation, and with the requirement for economies of scale likely to further industry consolidation. This may however concentrate systemic risk.

Different reforms are proposed for the SMSF sector including enhanced powers for the ATO, licensing of advisers to SMSFs, and auditor independence. The ATO was to be given the power to enforce mandatory education for trustees who have contravened the *SIS Act*. Otherwise, the Cooper reforms do not extend to mandatory training of trustee directors found in other jurisdictions.

Proposed reform of the *SIS Act* would remove or override provisions in some fund constitutions requiring a trustee to use a specific service provider. It attempted to regulate administrative efficiency through the implementation of SuperStream, a package of measures designed to bring systemically significant back office functions 'into the 21st century'.[191] Logically, service providers should all be subject to APRA supervision, including prudential regulation, and should be licensed. This should include custodians. Many providers operate in a fragmented and low margin industry with limited ability to raise investment capital, this is likely to lead to consolidation of funds management services entities.[192] Cooper recommended regulatory oversight of all critical elements of the investment chain, suggesting the superannuation system lacks 'systemic transparency'.[193]

These reforms opened the way for the appointment of independent directors not associated with employer or employee representation. It also requires directors to have specific skills necessary to govern the fund, without prescribing what these may be.[194] The requirement to be non-associated and the additional statutory duties in respect of conflicts of interest and higher standards of competency is likely to result in a smaller pool of eligible, suitably qualified trustee directors being available for board appointments.

Cooper proposed major reform to prudential regulation. Funds, including master trusts and companies where there is a trustee function within the conglomerate, will be required to establish operational risk reserves and to have their own prudential capital. This extends to funds administration entities in addition to new licensing requirements. Enhanced prudential requirements will be in addition to those required to maintain an AFSL.

APRA is proposed to have enhanced powers including the power to impose 'outcomes standards'. This extension of powers from prudential matters to the setting of operating standards are a form of

[191] Ibid pt 1 ch 1, 1.
[192] See below ch 2 s 4.5.
[193] Cooper, above n 43, pt 2 ch 3 'Investment Governance', 124.
[194] Ibid pt 1 ch 1, 31.

subordinate legislation made by the Executive Council and would be disallowable in the Senate. APRA will be able, as ASIC has presently, the power to impose contestable fines, as an alternative to criminal prosecution. The present APRA mandate is 'piecemeal':[195] it needed a revised mandate, expanded and redesigned to implement Cooper recommendations.

4.3.1 The legislative response

Legislative amendments designed to give effect to Cooper's recommendations became known as *Stronger Super*[196] enacted in a series of new or proposed new statutes. Prudential standards were increased.[197] These *Stronger Super* reforms reinforce, codify, and strengthen fiduciary principles from the general law. Some of these have been enacted, others await resolution of political impediments. The Superannuation Legislation Amendment (Trustee Governance) Bill remains before Parliament five years after Cooper.

The *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act*[198] amended the *SIS Act.*[199] It significantly enhanced the duties and responsibilities of the corporate trustee and its directors. Director duties are enhanced by the concept of a prudent superannuation trustee rather than an ordinary prudent person. Specific conflict of interest and fairness provisions are inserted into the *SIS Act*, and trustees are required to formulate investment strategy for each investment option, rather than the previous whole of entity approach. This includes valuation, taxation, costs, due diligence, diversification, economic scale, and liquidity considerations. These duties apply to individual directors personally as well as the corporate trustee. Substantive reform of the capitalisation of RSE licensees group 'connected entities' is required. Many are also REs. Undercapitalisation of the RE has been one of the systemic causes of the failures of MIS and requires prudential reform. APRA determines Prudential Standards; these regulate Fit and Proper[200] (but with implementation by the RSE), Investment Governance,[201] and Conflicts of Interest.[202] 'Fit and proper' means APRA being satisfied as to competence, character, diligence, experience, honesty, integrity and judgment, akin to German standards.

[195] Ibid ch 10, 309.
[196] Ibid.
[197] APRA, *Prudential Standards for Superannuation* (Discussion Paper, September 2011).
[198] *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Cth).
[199] *Superannuation Industry (Supervision) Act 1993* (Cth) ss 10, 29VN–VQ, 34, 52, 54.
[200] APRA, *Prudential Standards for Superannuation* (Discussion Paper CPS 520, September 2011).
[201] APRA, *Prudential Standards for Superannuation* (Discussion Paper SPS 530, September 2011).
[202] APRA, *Prudential Standards for Superannuation* (Discussion Paper SPS 521, September 2011).

A superannuation entity director is 'a person whose profession, business, or employment is or includes acting as director of a corporate trustee of a superannuation entity and investing money on behalf of beneficiaries of the superannuation entity'.[203] The legislation distinguishes trustee and director covenants to 'hold trustees to a higher standard',[204] being that of a 'prudent superannuation trustee'. These new trustee covenants include conflicts of interest, fairness, standards of care, skill, and diligence (for consistency with State trust law),[205] investment strategy (scrutiny, diligence, appropriateness, risk, composition, liquidity, ability to discharge liabilities, transaction and operating costs, taxation, and availability and reliability of valuation information, 'in particular [for] direct and unlisted investments that may be difficult to value'.[206] Reformed duties of individual superannuation directors[207] are an 'objective standard' and directors must 'each understand the business of the trustee and its regulatory framework and be in a position to contribute to the meetings of the trustee'.[208] Both the covenants of the trustee, and these new individual covenants 'operate as if the director of the corporate trustee of the RSE was a party to the governing rules'.[209] A member could personally seek redress for loss or damage from the person causing such loss or damage, although this liability has been ameliorated by the requirement for court approval to commence an action.[210]

MySuper beneficiaries delegate all aspects of their superannuation to the trustee. For RSEs offering default superannuation products, the trustee directors have personal liability for choice of fund. Cooper[211] proposed the selection and review of default superannuation products for listing in modern awards should include consideration of the quality of intra-fund advice.[212] This acknowledged the importance of investor education. Elsewhere, there is acknowledgement that, over extended periods of time, investor empowerment may change the mix of superannuation fund selection between default funds and from them to choice funds.

Criteria for the selection and assessment of superannuation funds eligible for nomination as default funds in modern industrial awards limit choice to those superannuation funds which offer a MySuper

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[203] *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Cth) Explanatory Memorandum, 1.33.
[204] Ibid 1.41.
[205] *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(2)(b).
[206] *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Cth) Explanatory Memorandum, 1.74.
[207] *Superannuation Industry (Supervision) Act 1993* (Cth) s 52A.
[208] *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Cth) Explanatory Memorandum, 1.133.
[209] Ibid 1.137; *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(8).
[210] APRA, *Prudential Standards for Superannuation* (Discussion Paper SPS 521, September 2011).
[211] Cooper, above n 43, rec 6.2.
[212] Productivity Commission (Cth), *Default Superannuation Funds in Modern Awards*, above n 173, 123.

product.[213] This is the interface between Australia's compulsory superannuation system and its industrial system. Superannuation was included as an allowable matter in awards in 1996.[214] Subsequently, 122 modern awards were developed by the Australian Industrial Relations Commission, now embedded in the *Fair Work Act*. In 2012, there were 104 superannuation funds named as default funds in at least one modern award.[215] Of these, APRA reports that 50% are industry public offer funds.

Stronger Super reforms sought to eliminate corruption in the investment chain. The *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act*[216] prohibits contracts where the trustee is required to use specific service providers, investment managers, or invest in specific financial products. Many of these have been related parties. It eliminates trust deed restrictions on voting power of individual directors. Such requirements, allowable under previous law, have been inserted into trust deeds particularly where there is common ownership or other related parties. Such provisions are void. The legislation restores the discretion of the trustee subject to the Prudential Standard.[217]

The right to offer default superannuation products is commercially highly contested, with high percentages of superannuation funds being invested in these default products involving more than a trillion dollars.[218] The Fair Work Commission creates the Default Superannuation List constructed by it as an Expert Panel. Only superannuation funds on this list may be designated as default funds in a modern industrial award.[219] These are selected by the employer for employees who otherwise do not, or are not allowed to make their own choices.

So, the governance of the selection process is paramount in default fund selection. In *Financial Services Council v Industry Super*,[220] the Financial Services Council (FSC) succeeded in its application to have the construction of the Expert Panel declared invalid and have it reconstituted. Expert Panel Members became disqualified from the selection process because of conflicts of interest.[221] Expert Panel Members are appointed 'following the Minister being satisfied as to their

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[213] Ibid 98.
[214] *Workplace Relations Act 1996* (Cth).
[215] Productivity Commission (Cth), *Default Superannuation Funds in Modern Awards*, above n 173, 48.
[216] *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013* (Cth).
[217] APRA, *Prudential Standards for Superannuation* (Discussion Paper SPS 231, September 2011).
[218] APRA, *Annual Superannuation Bulletin* (June 2013, revised 5 February 2014) 8.
[219] *Fair Work Act 2009* (Cth).
[220] *Financial Services Council Ltd v Industry Super Australia Pty Ltd* [2014] FCAFC 92 (Gilmour, Flick, & Perram JJ).
[221] Ibid [5] (Gilmour, Flick, & Perram JJ).

expertise in finance, investment management and/or superannuation'[222] which can be politicised. They represent a minority of Panel Members, and can be outvoted, despite selection on competencies.[223] Given the very significant commercial rewards, public conflicts between industry and retail superannuation lobbyists, and a contested political environment in superannuation, the governance of default superannuation selection requires reform.

4.3.2 Remediation

St John[224] addressed investor compensation as a result of AFSL and RSE malfeasance. Under present law, some investors are able to access compensation, others, notably in the SMSF sector have not been able to do so. They may be invested in the same financial products: St John shines light on the plight of investors damaged in the collapse of Trio Capital. He highlights other recurring features[225] including unlicensed and unregistered MIS, business model failure; poor or inappropriate financial advice, deceptive and misleading conduct in respect of financial products, and commission based inducements for financial products recommendation.

St John does not recommend a last resort scheme. Current compensation arrangements 'do not purport to deal with loss or damage suffered by consumers from investment failures other than as a result of licensee misconduct'.[226] The inquiry into the collapse of Trio Capital[227] concluded in relation to MIS, that 'if the objections raised by Mr St. John could be overcome, the concept of a levy on all MIS to fund a compensation scheme for fraud and theft has merit'.[228] However, there are significant practical difficulties if applied to existing MIS. This is where much of the need for compensation has arisen.

4.4 Entrepreneurship or South Sea Ponzi? — Managed Investment Schemes in Australia

The first decade of the 21st Century was a decade of prosperity in Australia. Some credit should be attributed to an entrepreneurial society using a reformed capital market and financial system able to source capital nationally and globally, to facilitate commercial expansion. It resulted in a plethora of new investment opportunities in MIS and superannuation entities.

The far from prosaic inventive spirits of financial product developers were aided by financial advisers. Many investments were lawful, some were not. Many complied with black letter law, but not its spirit.

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[222] Ibid [3] (Gilmour, Flick, & Perram JJ).
[223] *Fair Work Act 2009* (Cth) ss 620(1A)(b), 627(4).
[224] Australian Government, The Treasury [St John], above n 162.
[225] Ibid 52 [3.1].
[226] Ibid 155 [A.28].
[227] Senate, PJC, Parliament of Australia, above n 143.
[228] Ibid xix.

Investing clients often based decisions on trust, with limited product understanding sold to them by often conflicted financial advisers in an ex post regulatory environment. What should have led to a more entrepreneurial economy, and a richer more educated society instead inflicted continuing personal and economic damage. Recognition of a problem with MIS created the conditions for a Reaction. This was manifested in a series of reviews and reports. It began with an assessment of the legislative framework.[229]

The statutory definition of MIS refers to investor contribution being 'pooled or used in a common enterprise'.[230] MIS are typically structured as trust based or contract based. In no other country does the use of trusts as commercial trading enterprises approach Australian practice.[231] Trust based MIS operate as pooled investment fund involving investor contributions which become scheme property for application to scheme investments and operating costs. Common enterprise contract based MIS operate often on agency principles with investor contributions used in a common commercial enterprise without being pooled. Scheme property is separate to investor property. Investors, at least in theory and to satisfy tax authorities, needed to maintain the stance that they are carrying on a business. That their business sometimes had no commercial likelihood of success appears to have been irrelevant.

The Corporations and Markets Advisory Committee's (CAMAC's) 2011 review dealt with schemes and REs in financial distress. The financial damage had been of such an extent that the law required reform so that viable MIS under the control of a non-viable RE can be transferred to the control of a viable RE, potentially viable MIS can be restructured, and non-viable MIS can be wound up. There are legal and commercial impediments to each of these objectives. The 2009 Parliamentary Inquiry into Agribusiness MIS recommended a statutory amendment requiring ASIC to appoint a temporary RE. A major impediment, unless ASIC itself becomes the RE or indemnifies a new RE is the assumption of the liabilities of the former RE by its replacement. Historically, there has been a lack of REs prepared to assume responsibility for an existing MIS, even if it is financially sound.[232] This has led to orphan MIS.

[229] Australian Government, CAMAC, *Managed Investment Schemes* (Discussion Paper, June 2011).
[230] *Corporations Act 2001* (Cth) pt 5C s 9(a)(ii).
[231] Nuncio D'Angelo, 'The CAMAC Report on managed investment schemes: Another opportunity missed?' (2012) 23 *Journal of Banking and Finance Law and Practice* 256.
[232] See, eg, *Huntley Management Limited v Timbercorp Securities Limited* [2010] FCA 576 [69]; *Huntley Management Limited v Australian Olives Limited* [2010] FCAFC 98.

Each MIS must have a RE. Accounting treatments and entitlements of scheme members are different for each MIS. A

> lack of adequate separation of the affairs of each MIS operated by the RE and legal uncertainty of various parties dealing with the RE as operator of the various schemes. The greater the complexity of the MIS structure[s], the greater the risk of entanglement and confusion of the rights of investors and other parties.[233]

REs can be sole function or multifunction, and can be in-house where the NBFE also acts as promoter of the scheme (the Australian 'poacher-gamekeeper' syndrome).[234]

Reforms of this period proposed: identify the affairs of each MIS that an RE operates, place controls on the use of scheme property, and set out the rights of creditors of each MIS.[235] Rights established in the constitution of a MIS allowing the use of scheme property to pay debts of another MIS would be prohibited. Creditor rights would extend to scheme property and not be subrogated to the indemnity rights of the RE.

Common enterprise schemes with multi-function REs have been problematic.[236] Many agribusiness MIS fall into this category: 'the problems with the operations of schemes … have arisen principally, if not exclusively, in the context of common enterprise schemes',[237] considering whether the law should permit only pooled schemes. It is not correct. This option was not adopted when Part 5C of the *Corporations Act* was adopted in 1998 and does not recognise that pooled MIS (and their REs), have faced considerable difficulties.

Should the RE be sole purpose (MIS specific)? A large number of new REs, each with its own AFSL would be required. Equity capital to meet statutory AFSL capital adequacy requirements would be substantial. There would be no economies of scale.

CAMAC proposed that there be legislative reform creating an alternative legal framework: the Separate Legal Entity (SLE). In essence, the SLE would only act as agent of the MIS, not principal, a position that exists in practice in the MIS sector currently. 'Whilst the SLE proposal is theoretically workable, and if implemented, could be the answers to almost all of the issues',[238] it has not met with

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[233] Australian Government, CAMAC, *Managed Investment Schemes*, above n 229, 25.
[234] Ibid 4.
[235] Ibid 32 [3.4.2].
[236] Ibid.
[237] Ibid 10.
[238] D'Angelo, above n 231, 266.

scholarly approval.[239] For those that are not structured in this manner, there would need to be taxation reform.[240]

Many MIS finance the unlisted property sector. These MIS have been popular with retail investors in superannuation and non-superannuation environments. Some were unlawful unregistered MIS, being particularly problematic for investors exposed when the GFC uncovered their underlying legal and business model flaws. These flaws included non-compliance with AFSL conditions, poor compliance, risk management unsuited to the scale and complexity of the businesses, unsubstantiated cash flow forecasts, and related party transactions. Some related party transactions could not be shown to be in the interests of scheme members and ignored conflicts of interest compliance. [241]

Agribusiness and forestry MIS[242] were common in Australia. ASIC previously had not ascribed Ponzi characteristics to agribusiness MIS. It did concede, that in relation to forestry MIS:

> where a RE of a forestry scheme is reliant on scheme sales for a substantial part of revenue for working capital, an interruption to scheme sales revenue could have significant implications for the RE, and its contractual obligations owed to growers … Some RE's have not had sufficient reserves to fulfil their obligations to growers.[243]

There was no prudential capital requirement for these, or property MIS, until statutory intervention in 2017 and then only for those entities categorised as non-ADI (authorised deposit-taking institution) lenders.[244] They relied on attracting new investors to meet old obligations. Forestry MIS have often been highly leveraged using full recourse secured financial instruments, often provided by a related party of the RE. Most of these are common enterprise schemes where the investor is the 'grower', and where the entitlements of the investor/grower are not always clear. They created significant and ongoing financial hardship for their investors.

ASIC attributed common factors in forestry RE and MIS collapses to: reliance by the RE on its holding company (often multi-function REs where the RE is owned by the scheme promoter);

[239] Ibid 259.
[240] Australian Government, CAMAC, *Managed Investment Schemes*, above n 229, 14.
[241] ASIC, 'ASIC review of unlisted property MIS sector', above n 135.
[242] ASIC, Submission to Senate Standing Committee on Economics, Parliament of Australia, *Inquiry into forestry managed investment schemes* (September 2014).
[243] Ibid 13 [53].
[244] Exposure Draft Explanatory Materials, Treasury Laws Amendment (Non-ADI) Lender Rules) Bill 2017, 6 [1.14].

business models reliant upon fees from investors/growers or new investors for working capital; and limited ability to collect management fees from investor/growers.

ASIC noted that 'despite the reviews [CAMAC, summarised here] and a significant amount of work in developing potential refinements, the legislative framework for MIS has remained largely the same'.[245] That includes the statutory licensing obligations of ASIC in the granting of AFSLs and the registering of MIS. Licensing has been problematic for ASIC, including transfers of ownership of licencees. The FoFA reforms increased ASIC's licensing powers, but unacceptable changes of ownership magnifies systemic risk. ASIC noted:

> conduct standards in the *ASIC Act* are at best an imperfect tool for a regulator seeking to address systemic or widespread issues ...[246] findings that they have been breached tend to be specific in each case and rarely set a general rule or precedent,[247]

perhaps reflecting internal frustration that its regulatory powers do not match community expectations of it.

ASIC had previously questioned[248] the commerciality of these forestry (mainly pulpwood) MIS, the poor quality or absence of disclosure, inappropriate, conflicted or misleading advice, and payment of excessive fees to related parties. Investors relied upon their contracts. Consequently investors in these MIS have to rely on the general law where a power imbalances make equitable claims difficult to sustain. Severe community criticism of profiteering by MIS promoters at the expense of the taxpayer and investor, asymmetric information, lack of accountability, internal transfer pricing to hide below forecast returns, fee gouging, and reliance upon investor tax benefits as a marketing strategy for the MIS[249] demanded closure of these MIS and their banning from the retail investment market.

Industry views, unsurprisingly, accord with existing practice:

> whilst it is acknowledged there have been concerns about past practices of MIS companies and financial advisers marketing MIS products … subject to appropriate standards of due diligence and corporate governance, the MIS structure and plantation taxation arrangements should continue to be available to support new plantation investment … the key point that AFPA would like to make is that

[245] ASIC, Submission to Senate Standing Committee on Economics, Parliament of Australia, *Inquiry into forestry managed investment schemes*, above n 242, 22 [83].
[246] Ibid 30 [115].
[247] Ibid 35 [115].
[248] ASIC, *Compliance with advice and disclosure obligations: Report on primary production schemes* (Report 17, February 2003).
[249] David Cornish, MS&A Advisors to Australian Agriculture, *Proposed new taxation arrangements for investments in Forestry Management Investment Schemes* (Newsletter to clients, 2014).

> the MIS structure, in combination with the plantation taxation arrangement, has had some success in attracting private investment for new plantation establishment.[250]

Quite! There are 144 384 investors exposed to six groups of forestry MIS[251] to which external administrators were appointed between April 2009 and September 2012 and into which they had invested AUD5.812 billion. There are no reliable aggregate research data on consequential financial or human losses.

ASIC acknowledged a 'currently growing international interest in redirecting financial services regulation to more actively influence the quality of financial services and products provided to investors'.[252] An evolution to more interventionist regulatory approach aligning regulation of MIS with company law,[253] including ASX listed companies.[254] MIS have evolved former prescribed interest collective investment schemes[255] into large complex (sometimes listed) commercial enterprises structured as trusts controlled by multi-function REs, retaining different governance frameworks.[256] Prescribed interest schemes separated the trustee from the management company, an approach favoured professionally.[257]

Recommendations of CAMAC,[258] ASX guidance for listed MIS,[259] and international guidance[260] refer specifically to risk management, but the implications are clear that CAMAC believed that MIS should be regulated as companies. Reform options included investor rights in respect of oppression[261] and statutory derivative action.[262] What constitutes a MIS and who constitutes a member of a MIS already have broad definitions. These and which schemes should be registered are proposed for

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[250] Australian Forest Products Association, Submission to Senate Standing Committee on Economics, Parliament of Australia, *Inquiry into Forestry Managed Investment Schemes* (December 2014).
[251] Timbercorp Securities Limited, Great Southern Managers Australia Limited, FEA Plantations Limited, Rewards Projects Limited, Willmott Forests Limited, and Gunns Plantations Limited. Gunns had acquired nine of the Great Southern MIS and subsequently appointed an external administrator.
[252] ASIC, Submission to Senate Standing Committee on Economics, Parliament of Australia, *Inquiry into forestry managed investment schemes*, above n 242, 4 [7].
[253] Australian Government, CAMAC, *The establishment and operation of managed investment schemes* (Discussion Paper, March 2014).
[254] Ibid 232.
[255] The position prior to the *Managed Investments Act*, now *Chapter 5C Corporations Act.*
[256] The CAMAC Stage 1 proposal for the establishment of a Separate Legal Entity has not proceeded.
[257] A Jessup, *Managed Investment Schemes* (Federation Press, 2012).
[258] Australian Government, CAMAC, *The establishment and operation of managed investment schemes*, above n 253, 65.
[259] ASX, *Corporate Governance Principles and recommendations with 2010 Amendments* (2nd ed).
[260] IOSCO, *Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation* (2011).
[261] *Corporations Act 2001* (Cth) s 410.
[262] Ibid s 236(l).

reform. Alignment of MIS and company law results in reform of director's duties. Presently, if a MIS is listed, but the RE is not, the directors of the RE are not subject to the same disclosure requirements as directors of listed public companies.[263]

The MIS disclosure regime is not the same as for companies. The *FSRA*[264] did not harmonise the disclosure requirements for differing financial products and instruments despite them being commercial enterprises operating in competition in similar markets with similar investors. CAMAC proposed reform and alignment of disclosure regimes. For instance, a prospectus is a general disclosure obligation, whereas a product disclosure statement is a directed disclosure.[265]

Johnson[266] and CAMAC[267] both seek to align Australian practice to accommodate foreign investors in Australian MIS. It requires recognition of international standards of securities regulation: importantly, reforming architecture of a sole RE and asset valuation standards. There is a diversity of valuation methodologies used in Australia.[268] Should a MIS 'valuation procedure be limited only to those required by the accounting standards, regardless of the purpose of the valuation'? The International Organisation for Securities Commissions (IOSCO) sets out 38 principles required for Australia to meet international standards.[269]

Should principles underlying MySuper default funds be applied to MIS in Australia, then the European model of UCITS[270] compliant investment funds are a suitable model. These are able to be marketed across jurisdictions inside and outside of the EU, commonly so in some Asian jurisdictions including Singapore and Hong Kong, and are globally recognised. The UCITS framework has specific investor protection features including clarity about the depositary function. This contrasts with the uncertainty associated with the custodial function in Australia.

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[263] The predecessor of *Corporations Act* s 205G contained such a provision but this was eliminated in the *Corporate Law Reform Program Act 1999*.
[264] *Financial Services Reform Act 2001* (Cth).
[265] Australian Government, CAMAC, *The establishment and operation of managed investment schemes*, above n 253, ch 10.
[266] Johnson, above n 73.
[267] Australian Government, CAMAC, *The establishment and operation of managed investment schemes*, above n 253, ch 5, 71.
[268] Ibid ch 15, 227–228.
[269] IOSCO, *Principles for the valuation of Collective Investment Schemes* (May 2013); IOSCO, *Methodology for Assessing Implementation,* above n 260; see generally Australian Government, CAMAC, *The establishment and operation of managed investment schemes*, above n 253, ch 5, 67.
[270] Undertakings for Collective Investment in Transferable Securities.

4.5 Do custodians protect the investing public?

Custodial and depositary services providers are NBFEs.[271] Essential infrastructure and governance of superannuation and non-superannuation investment, they may have provided false sense of security. Cooper and ASIC both note that there are not many custodial services providers[272] in Australia,[273] despite increased international regulatory focus on the safety of client assets.[274] This is one of the unintended consequences of the *Managed Investments Act*. 'The market for custodian services has the highest level of [outsourced] concentration,[275] the top five custodians claim[ing] 92% of the entire market'.[276] This leads to the ability to charge higher fees.[277]

> Australian law is deficient by international standards in not mandating a requirement for an independent custodian to hold scheme assets. To permit self-custody and related party custody introduces a higher risk of maladministration.[278]

Cooper observed custodians do not conduct due diligence to protect investors against investment risks. Custodians are conduits for trustees and are not responsible to fund members for failure by them or other service provider. Turnbull noted[279] that custodians have never been intended to act as watchdogs and instead only act when instructed to do so and in accordance with instructions.

Custodians can hold assets for many funds without impact on capital adequacy. They can also be part of a vertically integrated financial services business. These are sources of systemic risk. Systemic risks in the custody sector are recognised in Europe, less so in Australia by ASIC and APRA.[280] Even for public offer funds, there is no link between the risks faced by the fund and the amount of prudential capital required. The provision of transactional back office services can lead to transactional error, but without the necessary capital adequacy for rectification. Client indemnities are of limited value. This was not previously so prior to the *Managed Investments Act*. At that time, trustee and custody

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[271] ASIC, *Holding Scheme Property and Other Assets* (Consultation Paper 197, December 2012); ASIC, *Custodial and depository services in Australia* (Report 291, 2012).
[272] ASIC, *Proposed Industry Funding Model for ASIC: Supporting attachment to the Government's Proposals Paper* (November 2016).
[273] ASIC, *Custodial and depository services in Australia*, above n 271, 4.
[274] Ibid 4, ref 8.
[275] Kevin Yi Liu, *Australian Superannuation: Operational Structure, Investment Performance and Trustee Governance* (PhD Thesis, The University of Sydney, 2013) 168. See below ch 6 s 3.1.
[276] Ibid.
[277] Ibid 173.
[278] Moodie and Ramsay, above n 55, pt 3, 78.
[279] In his review of the *Managed Investments Act 1998* (Cth), above n 62.
[280] Donald, above n 98, 35.

providers tended to be large, with considerable shareholder capital backed by insurance. Modern custody requires considerable capital investment in information technology.

ASIC have identified additional risks[281] including client money risk held in omnibus accounts in the name of the custodian or its nominee. Cooper observed that the prudential requirements for custody providers had not changed since 1983. ASIC has updated capital adequacy (separate from prudential capital) requirements for providers operating under an AFSL and RG166 in respect of managed investments schemes.[282]

ASIC research[283] analysed industry structure, regulatory regime, commenting on what it considers to be good practice. It did not establish new regulatory standards. ASIC reports an '"expectations gap" between custodians' present responsibilities and the publics' expectations of them in the safekeeping of assets and as gatekeepers for the identification and elimination of malfeasance'.[284] This extends to spurious asset valuations. Reform proposals to reflect market practice by changing the title 'custodian' to 'Manager's Payment Agent' may not be in the interests of investors. Reform needs to address systemic problems, not tinker at the edges.

Custodians are typically used by REs and RSEs in respect of superannuation entities where the RSE is the trustee. Custodians are defined in s 766E of the *Corporations Act* and Section 10 of the *SIS Act*. Persons holding the property of registered MIS are providing a financial service and are not providing a custodial or depository service. Similarly, a trustee of a RSE is not regarded to be providing custody services where that trustee holds the assets directly. The *Corporations Act* does not require the custodian to be named in Product Disclosure Statements, although this is common practice.

The *Corporations Act* exempts custodians of assets of registered schemes from the requirement to hold an AFSL.[285] They are not subject to statutory obligations regarding the holding of client money and property that apply to financial services licensees.[286] This control is exercised through the licensing of the RE which requires the RE to impose minimum contractual standards on the custodian and ensure minimum standards. The common view is that the custodian acts as bare trustee on behalf

[281] ASIC, *Holding Scheme Property and Other Assets*, above n 271, 7 tab 1.
[282] Previously set at eligible net tangible assets of AUD5.0 million for both APRA and ASIC purposes.
[283] ASIC, *Custodial and depository services in Australia*, above n 271.
[284] ASIC, *Holding Scheme Property and Other Assets*, above n 271, 5 [3].
[285] *Corporations Act 2001* (Cth) s 766E(3)(b)(i).
[286] Ibid pt 7.8 divs 2 and 3.

of and under instruction from the RE (or RSE) based in contract pursuant to the custodial agreement.[287] This may not be the expectation of the investing public:

> The relationship between the trustee and its custodian is thus potentially quite variegated, containing elements of trust, agency, debt, and contract. This variegation is crucially important in understanding the different ways in which local failures in respect of custody services can propagate and hence assume systemic implications.[288]

Custodians are commonly regarded as having a fiduciary responsibility to their RE and RSE clients.[289] They also have duties in respect of reporting suspected mis-, non-, or malfeasance.[290]

CP 197[291] proposed reform to address the deficiencies and uncertainties identified in the custody sector. These include pre-contract due diligence, watchdog function, and changes to terminology so that investors' expectations are more properly aligned with industry practice. These reforms raise significant legal and costs issues for custodial service providers and, together with increased capital adequacy levels, will almost certainly result in fewer market participants. If the role of the custodian is to include the watchdog role (pre- and post-contract with its client) and its associated reporting requirements to the regulator, then it is highly likely that this will become a concentrated sector with higher fees. Arguably however, the Australian custody sector has been charging fees commensurate with community expectations of responsibility but without providing assumed levels of service and risk mitigation.

These deficiencies and uncertainties were described in 2003.[292] Many remain: [t]he increasingly diverse set of services they provide to superannuation funds gives rise to systemic risk within the superannuation system … [but] little is currently done to manage this risk.[293]

Further,

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[287] ASIC, *Holding Scheme Property and Other Assets*, above n 271, [44]–[47].
[288] Donald, above n 98, 28.
[289] ASIC, *Holding Scheme Property and Other Assets*, above n 271, 16 [48].
[290] *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth); *Corporations Act 2001* (Cth) pt 9.4AAA.
[291] ASIC, 'ASIC review of unlisted property MIS sector', above n 135.
[292] Moodie and Ramsay, above n 55, 47.
[293] Donald, above n 98, 25.

> ASIC and APRA are increasingly aware of the potential for local risks to have systemic implications … for a variety of institutional, political and jurisdictional reasons they appear to be ill-equipped currently to address the threat …[294]

Australian law does not fully follow international standards.[295] These require a custodian be functionally independent of the operator and always act in the best interests of investors.

[294] Ibid 38.
[295] Moodie and Ramsay, above n 55, citing 46 IOSCO principle 2.

5. THE AGE OF STATUTES (2014 et seq)

5.1 Who is to blame? Has disclosure failed?

The scope and scale of financial damage, direct and indirect, led directly to community anger, political pressure, and to the search for scapegoats. Community expectations were different from market realities across much of the NBFE sector. Resulting economic hardships inevitably lead to emphasis on past losses and the search for remedies and scapegoats.

There are many thousands of cases which include:[296]

- 'Centrelink recipients earning A$23,000 p.a. aged 71 and 64 years receiving a loan of A$900,000 for investment into leveraged equities';
- 'Now aged 64, no longer a home owner for the first time in 34 years, robbed of a chunk of my rightful equity…'
- 'A single mother, advised by a broker to invest in property with a low doc loan, and struggling month to month to repay the loans';
- 'A person on a disability pension, forced to rent out her home and live with her daughter'.

These cases arose almost always from financial products investment through legally compliant disclosure documents and financial advice, undisciplined by financially literate clientele. The corruption of these Wallis inspired processes is facilitated by complex statutes and exposed in judicial frustration.

In *Wingecarribee*:

> Those Acts that now deal with misleading and deceptive conduct, apply differently depending on distinctions such as whether the alleged misleading conduct is in relation to a 'financial product or a financial service',[297] or 'financial services'.[298] Those apparently simple terms are nothing of the sort. … Obviously, there are differences in what each of these Acts and definitions cover – but why? The

[296] Australian Government, The Senate Economics Reference Committee, *Performance of the Australian Securities and Investments Commission*, above n 181; Senate Economics Reference Committee, Parliament of Australia, *Agribusiness managed investment schemes — Bitter Harvest* (2016) chs 3, 31; 4, 37; 6, 75; 11 ['*Bitter Harvest*'].

[297] *Corporations Act 2001*(Cth) s 1041H(1).

[298] *Australian Securities and Investments Commission Act 2001* (Cth) s 12DA(1).

> cost to the community, business, the parties, and their lawyers, and the time for courts to work out which law applies have no rational or legal justification.[299]

Public pressure and judicial findings led to reviews of ASIC's performance in 2014 and 2015, a further Parliamentary Inquiry into agribusiness MIS (*Bitter Harvest*), and the Financial System Inquiry (Murray) in 2014. For superannuation entities, a continuation of the *Stronger Super* agenda. The Heydon Royal Commission into Registered Organisations corruption paved the way for legislative reform of these systemically important entities.

There is no broad public understanding of regulators' mandates nor of the legal constraints under which they operate, particularly of ASIC. There is unmet public expectation of a zero failure system. Key findings 'resurface in different contexts throughout this work':

> ASIC appears to miss or ignore clear and persistent early warning signs of corporate wrong doing; ASIC needs to have the skills and industry experience to be able to match the ingenuity of those trying to circumvent the law; trust of consumers is open to abuse; consumers have an unrealistic expectation of what ASIC can do to protect their interests; ASIC's communication with retail investors and consumers needs to improve significantly; financial markets participants can assist ASIC enabling it to focus on serious and systemic matters; and some financial advisers, brokers, and lenders systematically targeted more vulnerable members of the community, especially older Australians with assets but without high levels of financial literacy.[300]

Case studies (with similar modern echoes) include Commonwealth Bank Financial Planning (CFPL) where,

> in particular, it showed ASIC as a timid, hesitant regulator … CFPL advisers deliberately neglected their duties, placed their personal interests ahead of their clients, misallocated client assets without knowledge or permission, received bonuses for same, conducted forgery and concealed material facts dishonestly, with management accused of a conspiracy hide these facts.[301]

Further: 'malfeasance escaped scrutiny, CFPL's compliance regime failed, and ASIC was too slow to recognise the seriousness of the problems within … with manifestly inadequate initial offers of compensation'. CFPL was not alone: other financial institutions have tolerated similar behaviours.

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[299] See ch 4 ss 2–4 for the effect of statutory complexity on investment decisions. See, eg, *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 (Rares J).
[300] Australian Government, The Senate Economics Reference Committee, *Performance of the Australian Securities and Investments Commission*, above n 181, [xvii].
[301] Ibid [xviii].

This 'CFPL scandal needs to stand as a lesson for the entire financial services sector and that a Royal Commission into it is warranted'.[302] The Hayne Royal Commission was finally constituted in 2018, yet to report. Further, 'without a fairer and more responsive regulatory system, the future will simply bring more stories of suffering and injustice with the same issues identified as the culprits'.[303] The public demanded action from ASIC to become a far more proactive regulator.

There are 'broad systemic problems in the financial advice industry' which may recur.[304] Recur they did requiring remediation of systemic deficiencies in 'culture, remuneration, record keeping, monitoring, review and remediation'. These were subsequently quantified by ASIC.[305] Empirical analysis identified compensation of AUD178.06 million to 203 452 investors who were financial advice clients of the financial planning arms of the four major banks and AMP.[306] This data does not include estimates of compensation for malfeasance from other financial institutions. Subsequent analysis of vertically integrated wealth management entities owned by AMP, ANZ, CBA, NAB, and Westpac providing financial advice on in-house superannuation products to retail clients revealed that only 10% of their advisers provided compliant advice, 65% did not, and 10% provided advice leading ASIC to have significant concerns about the consumers financial position.[307]

Financial literacy is the cousin of disclosure Australia in a market based regulatory regime.[308] 'Australia is out of step with international efforts to implement measures that would address problems associated with the marketing of unsafe products to retail investors,'[309] but later improvements in disclosure regulation were mostly tactical.[310]

This Senate Committee also recommended that the governance of ASIC revert to a two tier board structure with an executive and non-executive board, 'with the Commonwealth amending the *ASIC Act* accordingly'.[311] This approach must allow ASIC to better meet community expectations and address the financial literacy problem.

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[302] Ibid [xx].
[303] Ibid 361.
[304] Ibid 377.
[305] ASIC, *Financial advice: Fees for no service* (Report 499, October 2016) [29].
[306] Ibid [90]–[92].
[307] ASIC, *Financial advice: Vertically integrated institutions and conflicts of interest* (Report 562, January 2018) [20]–[21].
[308] Australian Government, The Senate Economics Reference Committee, *Performance of the Australian Securities and Investments Commission*, above n 181, 434.
[309] Ibid 442.
[310] ASIC, *Updating your disclosure documents — everything you need to know* (Regulatory Guide 97, 2016).
[311] Australian Government, The Senate Economics Reference Committee, *Performance of the Australian Securities and Investments Commission*, above n 181, 432.

5.2 Second Strategic Insights: objectives and implementation

A combination of community anger at a misunderstood and systemically deficient regulatory structure with an ageing demography preparing for retirement is toxic and dangerous. Economic change was predictable and predicted.[312] Deficient regulation was not. Systemic deficiencies were hidden by legislative accretion. Hardship driven policy change can destroy the benefits of what was an entrepreneurial economy. These benefits include investment options and the learning of financial literacy skills by investing. Regulatory interventions which destroy those freedoms risk returning Australia to pre-Campbell. The Age of Entrepreneurship becomes the Age of Statutes. Cooper's 'libertarian paternalism' being intervention by the State results in loss of investment freedom. 'You don't get a choice'.[313]

Campbell, Wallis, and Johnson acknowledged Australia's potential place in the global economy, and recommended appropriate implement policies. The Financial System Inquiry (Murray)[314] sought to remedy continuing policy deficiencies without damaging the entrepreneurial fabric. Australia's responses to implementation problems involved more legislation and more proactive regulation. Murray, supporting evolution to an ex ante system, sensibly seeks to balance these responses with an educated view of the principles and benefits of the Wallis regulatory architecture. Murray aimed to build on Wallis principles whilst reforming their implementation, concerned that poor investor outcomes make the 'system prone to more regulation… [and that] there does not need to be major change to Australia's regulatory architecture'.[315]

He expressed concern that reform should not be motivated by the political environment.[316] Governments have an obligation to act in the long term national interest not using the financial system for short-term political gain.[317] This impedes resolution of systemic problems including: instability in public policy for superannuation, regulation not keeping pace with practice and structure. The

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[312] J Reid and N Burns, *Long Term Asset Return Study, A Roadmap for the Grey Age* (Deutsche Bank AG Special Report, 12 September 2012); see generally Ross Garnaut, *Dog Days. Australia After the Boom* (Black Inc, 2013).
[313] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Interim Report* (December 2014) 904 (Commissioner Heydon).
[314] Murray, above n 44.
[315] Ibid [xviii].
[316] Ibid 30.
[317] Ibid 7.

absence of an overarching framework with clear definable objectives and success criteria means no clear accountability for participants.[318]

Murray proposed awarding ASIC a product intervention power to be exercised without a demonstrated or suspected breach of the law and extending to banning products, shifting from reliance on disclosure, advice and financial literacy to an ex ante posture. Failure risk is proposed to move from an ex post to an ex ante posture.[319] Ex ante regulation may seem reasonable in hindsight, but application of subjectivity in standards has the potential to ban all MIS product regulated by ASIC. This would be inconsistent with his desire not to make the financial system more prone to regulation. It also raises moral hazard. This is not an issue related only to complex financial products. Restriction of consumer choice has been an historical norm in other jurisdictions, limiting investment options to fixed interest products and lack of consumer awareness of the diversity of investment options found in Australia. This does not meet the Wallis objective of increased financial literacy. Murray supported mandated product disclosure standards, default products with simple features and fee structures, and generally supports the CAMAC proposals for the regulation of MIS.[320]

Murray opined that the current regulatory framework does not provide for the fair treatment of consumers of financial products and services. The Wallis principles of disclosure, advice and financial literacy are not met in practice. Eighty-five per cent of pre-retirees are not confident in having an informed conversation around retirement income.[321] He supported aligning Australian regulation with peer jurisdictions. This should include an 'appropriateness test' at the point of sale. This regime with differing detail is in place in the EU, UK, Japan, Hong Kong, Singapore and the US.

Reform of some NBFE ownership and control is proposed including ASIC approval for change of control of AFSL entities.[322] It mirrors proposed APRA approval for change of control of an RSE.[323] Murray considered (as does Johnson) that the Australian financial sector needs to be internationalised and that policy should avoid adopting unique Australian approaches inconsistent with international practice. For example adoption of common overseas collective investment structures (UCITS).

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[318] Association of Superannuation Funds of Australia (ASFA), *Response to the Financial System Inquiry* Interim Report, August 2014, 9.
[319] Australian Government, The Senate Economics Reference Committee, *Performance of the Australian Securities and Investments Commission*, above n 181, 83.
[320] Murray, above n 44, 273.
[321] Australian Super, Submission to The Treasury, *Financial System Inquiry*, 10th September 2014.
[322] Presently this is a notification. *Corporations Regulations 2001* reg 7.6.04(1)(i).
[323] Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017.

Elimination of the poacher-gamekeeper problem would require statutory amendment. Changes in other jurisdictions will need to be implemented in Australia as they occur.

AFSLs are effectively franchised: it being attached to the business unlike in other jurisdictions where the licence is attached to the individual. The AFSL business recruits financial planners as authorised representatives or employees. This encourages treaty shopping by planners for lower educational barriers to entry, the most advantageous fee splits, and feeds the pernicious effects of the approved products list needing volume business models to meet regulatory costs. The Australian regulatory regime does not have the veracity of the Canadian or Singapore jurisdictions: A Royal Commission is needed to 'compel relevant people to give evidence and to produce information or documents'.[324] Licensing of financial advisers would be personal, as in New Zealand and Hong Kong, rather than corporatised with an Approved Representative structure. This could fundamentally alter the valuation of those licenced NBFEs, explicit in Murray:

> the benefits of competition are central to the Inquiry's philosophy. High concentration and steadily increasing vertical integration has the potential to limit competition in the future. Licensing provisions and regulatory frameworks can impose significant barriers to entry and growth of new players.[325]

Lack of clarity around the objective of superannuation policy contributes to ad hoc short term decision making: it is not clear that the superannuation system is to provide an individual with an income in retirement. Murray proposed that this be enshrined in legislation. [326]

Without clarity of purpose, superannuation, retirement policy and regulatory architecture cannot be aligned and so cannot deliver the right outcomes. Whilst the accumulation phase in superannuation is heavily regulated, the retirement phase is underdeveloped and does not meet the needs of many retirees, needing reform of implementation. These include competitive selection of MySuper default funds, replacement of the industrial relations system in the selection of default funds, and alignment of the system to individuals, not employers.

Murray considered two alternatives in the further reform of MySuper: (i) abolition of the Fair Work Commission (FWC) process for selecting default funds in awards; and (ii) enhance the default superannuation licensing regime and APRA's role with it. It recommended that all employees should be able to engage with their superannuation and to choose their fund which receives their compulsory

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[324] Australian Government, The Senate Economics Reference Committee, *Performance of the Australian Securities and Investments Commission*, above n 181.
[325] Murray, above n 44, 255.
[326] Ibid 6.

superannuation contributions. This would require reform of the *Superannuation Guarantee (Administration) Act* to remove the exclusions given to enterprise agreements, workplace determinations, and some awards.[327]

The industry raised other options,[328] whilst preferring existing trust structures. These other options include a statutory government controlled fund, which, whilst it may have simple and prudential attractions, removes competition and investor flexibility. It also opens the way for investment allocation decisions in an ill-defined policy framework, even if trustees believe those decisions are in the best interests of members, however defined. Other jurisdictions have government controlled funds (eg Singapore Central Provident Fund). The Australian experience includes the Future Fund, QSuper and Queensland Investment Corporation.

Governance is to be improved by a majority of independent directors on superannuation trustee boards and reforming director penalties for malfeasance with those for MIS[329] Murray does not agree with the Cooper proposals for industry fund corporate governance believing it is more important for directors to be independent, skilled and accountable than representative.[330] Murray believes that there is no evidence to suggest that the performance of these funds is driven by their equal representation model, and that good governance can add to pension fund investment returns. Some submissions[331] favoured the Cooper approach that superannuation trustees should exercise their fiduciary duty to additionally consider longevity and inflation risks.

Alignment of penalties will expose directors of corporate trustees to similar civil and criminal penalties. In 2014, superannuation trustee directors were not subject to criminal or civil penalties for breach of duty to act in the best interest of members. APRA may seek to disqualify the director through court proceedings, but the position is inconsistent with the regime applying to RE directors under the *Corporations Act*.[332] Murray also proposed significant increases in the penalty regime.

ASFA suggests:

> There are mixed messages being sent by APRA in relation to its expectations around the obligations of boards … the approach adopted by APRA is not always consistent with the roles of boards and their

[327] *Superannuation Guarantee (Administration) Act 1992* (Cth) pt 3A s 32C.
[328] ASFA, *Response to the Financial System Inquiry*, above n 318, 54.
[329] Murray, 44, 93.
[330] Ibid 135.
[331] ASFA, *Response to the Financial System Inquiry*, above n 318, 124.
[332] *Corporations Act 2001* (Cth) s 601 FD, pt 2D.1.

> management … given the board role is strategic in nature, this is not an appropriate or constructive way to regulate boards.[333]

ASFA research demonstrates:

> APRA (inappropriately) expects managerial level responsibilities [for] board members and that APRA should provide guidance to clarify its expectations on the role of boards and distinguish these from the operations of management.[334]

Australia in 2018 does not have consistent corporate governance practices across the NBFE sector. Nor does it have consistent penalties for directors under each of the *Corporations Act*, *SIS Act*, and *Fair Work (Registered Organisations) Amendment Act*, each the responsibility of different regulators. Some inconsistency is attributable to differing mandates and objectives, but evolutionary radiation of the statutes has resulted in different outcomes resulting in directors being required to 'collate their duties from different sources'. There is limited alignment of director duties between APRA regulated superannuation trustees and funds with REs and registered MIS, even though they can have common ownership and common directors.[335] Unit holders in a MIS can remove the RE, although they cannot remove individual directors. Members of superannuation funds have no such rights. The *Corporations Act* sets out the obligations of directors of a RE, but the regulatory framework is a different standard and not as comprehensive as its equivalent for an APRA supervised RSE. This complexity and inevitable uncertainty applies also to the regulators, whose officers need up-skilling to identify the investment trail through different structures, entities, and jurisdictions.

Murray did not agree with other proposals to return APRA and ASIC to two tier board governance models. He did agree that ASIC and APRA are both subject to policies that limit their capacity to attract and retain skilled staff from the private sector. Of the three primary regulators, only ASIC is subject to the *Public Service Act*. Both are staffed predominantly by people with legal training. The reliance on litigation to resolve complaints in investment markets is likely to lead to unsatisfactory and highly selective caseloads, which explains in part the reliance on enforceable undertakings.

He proposed that ASIC should emulate APRA and move to funding from industry levies, now enacted. This is consistent with the original but incomplete Wallis recommendations which in the event were only applied to APRA. Industry commentary is generally supportive of the outcomes

[333] ASFA, *Response to the Financial System Inquiry*, above n 318, 63.
[334] Ibid 64.
[335] Ibid 93. In 2014, c 78% of all consolidated assets in managed funds involved the superannuation system.

based approach adopted. Murray notes that confidence and trust cannot be prescribed in legislation. Neither can a disclosure based regime be relied upon in isolation. But his responses are mainly tactical with more accretive statutory change. His underlying theme is establishing and maintaining a healthy industry culture supported by well-staffed and funded regulators. He did not say how. That was left to Heydon.

5.3 Revealing an Achilles Heel? 'An unhealthy culture'[336]

Australia is regularly reported to now have the fourth largest pool of superannuation savings in the world. There is an inevitable nexus between the world's fourth largest pool of superannuation savings and its vulnerability to malfeasance. Aggregate superannuation assets were AUD2.504 trillion on 30 June 2017.[337] These assets are held approximately 25% each by industry, excluded public sector, retail, and small (SMSF) funds. APRA regulated funds of four or more members account for AUD1.62 trillion of assets. Control is highly concentrated across 138 RSEs managing 209 funds controlled by 1034 directors of those corporate trustees.[338] These entities generate some AUD9.4 billion annually in funds management fees. 20 funds control 90% of these funds.[339] Superannuation default funds (112 MySuper products) account for 23.75% of aggregate superannuation assets or 36.8% of APRA regulated entities. These are heavily skewed with industry funds holding 64.4% of their total assets in default funds,[340] a larger proportion than other superannuation entities. Aggregate superannuation assets are approximately equal by some measures to the assets held by the Australian banking system.[341] Approximately 23.4% of APRA regulated superannuation (AUD0.379 trillion) is invested in Australian listed equities.[342]

Concentration of control in retail and industry funds, a limited pool of trustee directors, combined with substantial fee generation and ability to transfer RSE and AFS licenced entities by contract presents significant systemic risk. The interface between Australia's industrial system (which governs

[336] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report* (December 2015) ch 2, 3 (Commissioner Heydon).
[337] APRA, *Annual Superannuation Bulletin* (June 2017, released 28 March 2018).
[338] Ibid 5.
[339] Trish Power, *Exposing the performance history of Australia's largest 200 super funds*, Superguide (Newsletter, January 2014).
[340] APRA, *Annual Superannuation Bulletin* (2017), above n 337, 22.
[341] Measured as 'Total gross loans and advances' of AUD2.563 trillion. APRA, *Monthly Banking Statistics* (February 2018). See also Australian Government Productivity Commission, *Competition in the Australian Financial System* (Draft Report, January 2018) pt 1 sec 1.1 fig 1.1 which reports banks having 55% of total assets, NBFEs including superannuation 45% of total assets.
[342] ASFA, *Superannuation Statistics* (December 2017).

industry superannuation) and its superannuation savings system is therefore of national significance. As Murray and Heydon note, this interface is largely unexplored territory.

The influence of Registered Organisations in the investment economy is driven by compulsory superannuation outsourced to the private sector. It is a recent phenomenon. This influence has not attracted the regulatory attention it deserves: until Heydon:[343]

> the existing criminal laws do not appear to operate as much of a deterrent to employers giving and union officials taking bribes, secret commissions and other lawful payments … History appears to be repeating itself …[344] It is a recurring problem…. it is insidious. It is immensely damaging … longstanding … clandestine …[345]

Heydon identified unhealthy culture facilitating corrupting benefits of various forms as related party transactions as cultural problems 'antithetical to the rule of law ... if unchecked, the culture comes to taint and impact the wider society'.[346] There are 'significant issues about the scope and effectiveness of existing law concerning the duties of union officers … existing law appears to have done nothing to prevent the apparent egregarious misappropriations of … assets'.[347] Utterly derisory … manifestly inadequate…'[348] Systemic failure of regulation to prevent improper conduct by officers of registered organisations: members of the public and the organisations concerned surely would agree — how can this be?

> Recent examples of financial misconduct within registered organisations have demonstrated that the existing regulatory framework is not sufficient to provide members of registered organisations with confidence that the management of registered organisations is accountable and transparent and that their membership contributions are being used for proper purposes.[349]

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[343] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Interim Report*, above n 313; Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336.
[344] 1982 Winneke Royal Commission; 1992 Gyles Royal Commission; 2003 Cole Royal Commission; Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 4, 29–30 (Commissioner Heydon).
[345] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 4, [58] (Commissioner Heydon).
[346] Ibid ch 4, 10 (Commissioner Heydon).
[347] Ibid ch 3, 2 (Commissioner Heydon).
[348] Ibid ch 3, 89 (Commissioner Heydon).
[349] Revised Explanatory Memorandum, Fair Work (Registered Organisations) Amendment Bill 2014.

‘Sunlight is said to be the best of disinfectants …’[350]

5.4 Registered Organisations

A registered organisation is an organisation registered under the *Fair Work Act*.[351] The relationship between a registered organisation and its officers is one of dependence. Trade unions and employer groups are registered organisations. Some have established funds for various objectives. Officers of registered organisations are fiduciaries owing their duty to the registered organisation rather than to its individual members. This is similar to previous law in respect of trustee directors of superannuation funds corporate trustees and present law in respect of directors of the RE of a MIS.

Various duties are also imposed upon the officers of a registered organisation by the *Fair Work Act*.[352] It does not impose a series of general obligations owed by officers in the performance of their duties and in the exercise of their powers. The statutory duties only apply to financial management[353] and compliance with certain orders and directions.[354] ‘Financial management’ is not defined in the *Fair Work Act*. This is not the same governance standard applying to directors under the *Corporations Act*.[355] Neither is the duty to act in good faith: the *Fair Work Act* (amended 2016) required an officer to act ‘in what he or she believes to be’ the best interests of the organisation, a lesser obligation than that in the *Corporations Act*.[356] Despite their systemic importance, directors and officers of registered organisations emanate from a different tradition with lesser legal standards. That they also direct and manage superannuation entities and MIS with higher and different standards may not be recognised.

Registered organisations represent approximately 1.9 million trade union members. There are 112 registered organisations (109 in December 2015),[357] of which 67 are ‘employee’ organisations, 49% of which control net assets of between AUD5.0 and AUD50.00 million.[358] Registered organisations are ‘most likely to be small employer organisations or large employee organisations’[359] (90% by type

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[350] Polina Demina, ‘Broker-Dealers and Investment Advisers: A Behavioural Economics Analysis of Competing Suggestions for Reform’ (2014) 113 *Michigan Law Review* 440 citing Louis D Brandeis, *Other Peoples’ Money and How the Bankers Use It* (F A Stokes, 1914).
[351] *Fair Work (Registered Organisations) Act 2009* (Cth).
[352] Ibid.
[353] Ibid s 283.
[354] Ibid s 294.
[355] *Corporations Act 2001* (Cth) ss 180–184.
[356] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Interim Report*, above n 313, 48 [33]–[34] (Commissioner Heydon).
[357] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 1, 78 (Commissioner Heydon).
[358] Revised Explanatory Memorandum, Fair Work (Registered Organisations) Amendment Bill 2014 (Cth) (x).
[359] Ibid.

with c 1.9 million members) being a significant imbalance in membership numbers. Some employee organisations have commercial size and complexity including companies and trusts, related parties, and operate in multiple jurisdictions. These data are estimates, tempered by 'a high prevalence of failure to lodge reports, later reports, and inconsistency in reporting periods'.[360]

Their officers 'occupy a position of considerable trust. They are in charge of substantial sums of money which is not their own'.[361] This trust may have been misplaced:

> the Commission have identified or exposed serious failures in the governance and financial management of a number of unions. Among other things …[362] misappropriation; failures by committees of management to oversee; or to scrutinise union finances, either properly or at all; lack of internal accounting and audit; failure of external accounting and audit; lack of, or unawareness about, union policies dealing with financial matters; and misuse of credit cards, and 'those in charge of the union treated the union's money as if it were their own.[363]

State statutes impose duties on officials of registered organisations which bear similarity to those statutory duties imposed on company directors by the *Corporations Act*.[364] A registered organisation is a body corporate, a legal entity. This dual regulation of registered organisations varies between jurisdictions and opens the way for this 'unhealthy culture' to develop in those with lesser regulatory standards. In Queensland, there is a statutory obligation to have rules governing financial expenditures,[365] which is not mirrored in other states or by the Commonwealth, a situation proposed to be rectified.[366] This statutory obligation is to extend to financial disclosures, internal compliance, internal audit and compliance with separation of powers between the financial compliance officer and the Secretary, external audit requiring fit and proper assessment similar to company auditors, record keeping including minutes, and financial records.

There has been debate as to whether the officers of a registered organisation are subject to the *Corporations Act*.[367] Not unless the officers of the registered organisation conduct, proposes to

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[360] Ibid (ix).
[361] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 1, 78 (Commissioner Heydon).
[362] Ibid ch 2, 2 (Commissioner Heydon).
[363] Ibid ch 2, 3 (Commissioner Heydon).
[364] *Industrial Relations Act 1991* (NSW); *Industrial Relations Legislation Amendment and Repeal Act 1995* (WA); *Industrial Organisations Act 1997* (Qld).
[365] *Industrial Relations Act 1999* (Qld) s 553A.
[366] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 2, 80 rec 9 (Commissioner Heydon).
[367] *Health Services Union v Jackson (No 4)* [2015] FCA 865 [55] (Tracey J).

conduct, or make a decision to refrain from conducting business outside of Australia.[368] The increasing scope and scale of commercial operations, including superannuation decisions, is likely to expose those officers accordingly, including criminal liability,[369] to which they are not exposed to under the *Fair Work (Registered Organisations) Act*. Hence, the transfer of 'unhealthy culture' into entities differently regulated and supervised becomes a matter of diffusion without the relevant officers necessarily understanding the difference, and without other directors of those entities comprehending these traditional distinctions. This is extremely dangerous and compromises 'fit and proper' requirements of directors and trustees of those entities.

Present Commonwealth statutory duties, whilst reflecting *Corporations Act* provisions are constrained by significant limitations which have allowed malfeasance develop. These include Commonwealth (not State) statutory responsibility limited to financial management (undefined);[370] the good faith duty defined as 'in what they believe to be the best interests of the organisation';[371] civil penalties only; no disclosure requirement or voting prohibition of related party and personal interests although the organisation itself is required to have such rules. 'The obvious implication is that breaches of duty by officers in relation to matters other than those 'in relation to financial management' are unimportant'.[372] 'It seems peculiar that union officer's statutory duty to the union should not extend to conduct that has an adverse financial effect on the union'.[373] There are plenty of examples. Similarly, subjective qualification of the best interest duty is not comparable with the *Corporations Act*[374] and an officer could only breach that duty 'if that officer did not subjectively believe (now statutorily remedied) that what he or she was doing was in the best interests of the organisation'.[375] The *Corporations Act* contained a similar phraseology until 1998,[376] the intent being an objective standard, albeit with subjective elements.[377] 'It must be a view which a person in the same position as the officer, having the same knowledge and skills, could reasonably have formed'.[378]

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[368] *Corporations Act 2001*(Cth) s 190A.
[369] Ibid ss 180–184.
[370] *Fair Work (Registered Organisations) Act 2009* (Cth) s 283.
[371] Ibid s 286.
[372] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 3, 56 (Commissioner Heydon).
[373] Ibid ch 3, 60–61 (Commissioner Heydon).
[374] *Corporations Act 2001*(Cth) s 181(1).
[375] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 3, 65 rec 27 (Commissioner Heydon).
[376] *Corporate Law Economic Reform Program Act* 1998 (Cth).
[377] *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1 [923] (Owen J).
[378] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 3, 75 (Commissioner Heydon).

Heydon opines that funds established by registered organisations 'pose significant governance issues'.[379] Those same officers may operate funds established by the organisation:

> often these funds have no adequate record keeping, management decisions are made informally or without due process, directors or shareholders meetings are not held, but if they are minutes are not kept, records are often maintained in a haphazard fashion, and transactions are often effected by cash.[380]

This contrasts markedly with the obligations of directors of companies, REs of MIS, and superannuation trustee directors. These standards are higher particularly in respect of disclosure, conflicts of interest and related party transactions. They derive from the *Corporations Act* (including financial services provisions), *Trustee Act*(s), *SIS Act*, State industrial relations statutes, and general law principles. Some registered organisations are associated with REs and RSEs to which they appoint directors. The tradition of their lesser standards influences the governance of these entities and could in the future lead to the ability of superannuation entities to influence the governance of listed public companies through asset allocation decisions.[381] Associated entities also include insurance and worker's entitlement funds. 'They provided only the most basic of information about related party transactions. Often the relationships between a union and trusts controlled by the union were not disclosed at all'.[382] Whilst there is a requirement to comply with the Australian Accounting Standards, breach of this rule 'has no financial consequences'.[383] The commissioner expresses unease about the closeness of such arrangements especially where there is no choice of fund,[384] proposing to amend s 32C(6) of the *Superannuation Guarantee Act*[385] by deleting paras (d) and (h).

Statutory[386] and fiduciary duties are imposed on officers of registered organisations. Heydon did not explicitly deal with *Barnes v Addy* liability of fiduciaries, but does reflect on the importance of the

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[379] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Interim Report*, above n 313, 22 [70] (Commissioner Heydon).
[380] Ibid 22 [71] (Commissioner Heydon).
[381] Above n 342. AFSA data illustrates the quantum of funds under management allocated to Australian listed equities.
[382] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 5, 10 (Commissioner Heydon).
[383] Ibid ch 5, 13 (Commissioner Heydon).
[384] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Interim Report*, above n 313, 936 [76]–[83] Commissioner Heydon).
[385] *Superannuation Guarantee (Administration) Act 1992* (Cth).
[386] *Fair Work (Registered Organisations) Act 2009* (Cth) cited in Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 9, pts 2–3 (Commissioner Heydon).

fiduciary tradition. He does document instances of the first limb transfer of trust property by fiduciaries with knowing assistance required for Baden second limb liability.

Despite arguments to the contrary, 'there are clear and convincing arguments in favour of maintaining statutory duties upon trade union officers backed by appropriate sanctions that can be requested by an independent regulator'.[387] Registered organisations are bodies corporate with separate legal entities having officers and directors 'in charge of other people's money, with all the responsibilities and temptations that arise … both are fiduciaries'.[388] However there are significant differences in that company shareholders have an economic interest where members of registered organisations usually do not have that direct economic interest. They do have an indirect economic interest through industry superannuation, direct investment, insurance and the management of workers' entitlement funds. An analogy is the use of trusts for MIS, many of which are large complex commercial enterprises. Notably, there are many companies subject to the *Corporations Act* which are not-for-profit or charitable purposes.

5.4.1 Disclosure

Disclosure is at the heart of the Wallis principles governing collective investment schemes. Registered organisations have not been subject to the same disclosure requirements, merely being required to themselves have rules requiring disclosure of personal interests to the organisation and the members of it.[389] Union officers can be indemnified by their union, and thus face no personal deterrent or consequences, fines being paid by the union members. However, the enforcement power 'requiring an individual to do anything is limited … [and] substantially undermines the effectiveness of the disclosure requirements'.[390] Similarly, recusal from decision making where there are or may be conflicts of interest should be aligned with those for company directors.[391]

5.4.2 Members' powers

Members have very limited powers to compensation for breach of duty in an environment of 'bullying, intimidation, and victimisation of those opposed to the interests of the union Secretary'.[392]

[387] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 3, 13 (Commissioner Heydon).
[388] Ibid ch 3, 27 (Commissioner Heydon).
[389] *Fair Work (Registered Organisations) Act 2009* (Cth) s 148B.
[390] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 3,143–144 (Commissioner Heydon).
[391] Ibid ch 3, 151 rec 32 (Commissioner Heydon); *Corporations Act 2001*(Cth) s 195.
[392] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 2, 2(h) (Commissioner Heydon).

Alignment of member powers with company shareholder powers is proposed.[393] Relevantly, there is 'no prescribed consequence for a person who continues in an office after disqualification',[394] whereas a company director would commit a criminal offence. Officers of registered organisations 'who have committed significant criminal offences can still continue to hold office.'[395] This also holds for those who have committed *Fair Work* civil offences. Substantive reform including a consistent 'fit and proper' requirement is required for better governance of registered organisations and to prevent the infection of other entities associated with them and their officers by this 'unhealthy culture'. For members of a registered organisation, there is no provision for a member to take a statutory derivative action on behalf of that organisation. Any member who seeks a rectification of malfeasance within the organisation is statute barred from obtaining compensation.[396]

5.4.3 Penalties

Heydon proposed aligning civil penalty regimes by amending the *Corporations Act* to remove the fixed upper penalty limit measured in dollars[397] and to impose criminal liability aligning *the Fair Work (Registered Organisations) Act* with it.[398] Penalties enured by the insertion of a 'corrupting benefit' Commonwealth statutory criminal provision for givers and recipients,[399] thus ensuring a 'uniform, clear and relatively simple regime applying throughout Australia.'[400]

It is presently lawful for collective agreements and enterprise agreements to continue to contain terms which do not allow for choice of fund by the member, despite the compulsory nature of the superannuation fund contribution.[401] Heydon recommends that these be deleted from the *Superannuation Guarantee Act*.

A single Registered Organisations Commission (ROC), separate from ASIC, was established at the fourth attempt in December 2016.[402] The ROC has similar powers to ASIC with 'information

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[393] Ibid ch 3, 161 rec 33 (Commissioner Heydon); *Corporations Act 2001*(Cth) ss 236–242.
[394] Commonwealth, Royal Commission into Trade Union Corruption and Governance*, Final Report*, above n 336, ch 3, 171 (Commissioner Heydon).
[395] Ibid ch 3, 173 (Commissioner Heydon).
[396] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Interim Report*, above n 313, 55 [50] (Commissioner Heydon).
[397] Commonwealth, Royal Commission into Trade Union Corruption and Governance*, Final Report*, above n 336, ch 3, 116 rec 28 (Commissioner Heydon).
[398] Ibid ch 3, 131 rec 29 (Commissioner Heydon).
[399] Ibid ch 4, 54 rec 40 (Commissioner Heydon); reform enacted by *The Fair Work Amendment (Corrupting Benefits) Act 2017* (Cth).
[400] Commonwealth, Royal Commission into Trade Union Corruption and Governance*, Final Report*, above n 336, ch 4, 54 (Commissioner Heydon).
[401] *Superannuation Guarantee (Administration) Act 1992* (Cth) pt 3A s 32C.
[402] *Fair Work (Registered Organisations) Amendment Act 2014* (Cth).

gathering, investigatory and enforcement powers',[403] and the power to accept enforceable undertakings.

5.5 The diffusion of unhealthy culture

The unhealthy culture identified by Heydon can be improved.[404] But the training of registered organisation officers had limited and unenforceable statutory obligations.[405] Repeal and replacement by a statutory provision requires 'all members of the committee of management of an organisation or branch, and all officers whose duties relate the financial management of the organisation or branch, to undertake approved training'.[406] This includes employees with financial responsibilities to also undertake approved training. Cultural change through education should not be restricted to those responsible for registered organisations. Lack of skills, knowledge, and adherence to general law fiduciary principles is problematic throughout NBFE governance.

Examples of the diffusion of unhealthy culture can be found in the industry superannuation and registered MIS sectors involving related party registered organisations. For example, Cbus is a superannuation trust, part of a group of NBFEs managing some AUD32 billion of FUM (some categorised as Default Funds) with United Super Pty Ltd as trustee and Superpartners Pty Ltd as administrator. The directors of the trustee were comprised of employer and employee (three from the CFMEU) representatives with one independent director. Loss of default provider status with the CFMEU would amount to loss of 15% to 20% of revenue,[407] the retention of which required the recruitment by Cbus of a former CFMEU as liaison officer with power to influence the identity and terms of building contracts funded by Cbus:

> the culture within Cbus is such that, even at the most senior of levels, staff are not willing or able to acknowledge (let alone address) the difficult and complex issues and conflicts of interest that arise as a result of the powerful position that the CFMEU holds vis-à-vis Cbus.[408]

This culture resulted in the release of confidential information by the trustee to CFMEU officials potentially contravening the trust deed, Cbus privacy policy, contracts with employees, *Privacy*

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[403] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 2, 50 (Commissioner Heydon).
[404] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report* (December 2015) ch 2, 3 (Commissioner Heydon).
[405] *Fair Work (Registered Organisations) Amendment Act 2012* (Cth) s 154.
[406] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 2, 78, rec 8 (Commissioner Heydon).
[407] Ibid vol 5 ch 7.1, 278 (Commissioner Heydon).
[408] Ibid vol 5 ch 7.1, 280 (Commissioner Heydon).

Act,[409] and the *Corporations Act*.[410] It breached the sole purpose test arising from the financing of industrial litigation using members funds. Behavioural standards of related parties at the heart of governance of Cbus resulted in unlawful transfer of trust property, being confidential information.

> But that law abiding tendency may be less marked when the CEO of a business running a large superannuation fund heavily dependent on the goodwill of trade union officials to ensure a flow of contributions is rung up by a forceful and very senior CFMEU official with what the official views as a pressing request.[411]

Workers Entitlement Funds are established, normally as joint ventures, to provide for employee entitlements, particularly in the construction industry. Aggregate FUM is reported to be approximately A$2.0 billion.[412] WEFs are registered MIS, but are exempted from Part 5C of the *Corporations Act*.[413] Most have a corporate trustee with its directors nominated by the joint venture partners, primarily from registered employer and employee organisations. There is 'very little specific legislation regulating their activities',[414] and has led in some instances to the 'substantial forfeiture of entitlements'.[415]

Direct forfeiture risk and other risk of loss through grant payments to related parties is attributable directly to the Class Order exemption hitherto provided annually by ASIC which exempts these funds from normal mandatory disclosure requirements to MIS members. This class order is an example of statutory complexity producing a 'double edged sword … alleviat[ing] the burden of compl[iance] where those requirements are not beneficial',[416] It explains how legal complexity, abetted by noble regulatory intention facilitates malfeasance. Mechanisms include: commissions and payments to joint venture partners; fees and charges; entitlement to payments from the fund; equal treatment of fund members by class; distribution of fund income as capital to joint venture partners rather than

[409] *Privacy Act 1988* (Cth).
[410] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, vol 5 ch 7.1, [249]–[270] (Commissioner Heydon); *Corporations Act 2001* (Cth) ss 182, 183, 79.
[411] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, vol 5 ch 7.1, [225] (Commissioner Heydon).
[412] Ibid ch 5, [52] (Commissioner Heydon).
[413] ASIC, *ASIC Class Order – Employee Redundancy Funds: Relief* CO 02/314, 19 March 2002, repealed but with interim extension to 17 December 2015. See generally CP 238 *Remaking ASIC Class Order on employee redundancy funds*, 4 September 2015 and ASIC Report 463 *Response on submissions to CP 238*, December 2015. ASIC has fashioned a new legislative instrument *[CO 02/314] — ASIC Corporations (Employee Redundancy Funds Relief) Instrument 2015/1150* — to extend relief to 1 October 2018.
[414] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, ch 5, 53 (Commissioner Heydon).
[415] Ibid ch 5, 76 (Commissioner Heydon).
[416] Hui Xian Chia and Ian Ramsay, 'Section 1322 as a response to the complexity of the Corporations Act 2001 (Cth)' (2015) 33 *Companies & Securities Law Journal* 389, 398.

members; entitlements if any paid in nominal dollars without the benefit of earnings generation and reinvestment, and costs arising from conflicts of interest and resulting breaches of fiduciary duty.[417] Direct net forfeiture and grant payments to related parties in the case of Incolink[418] over the period 2011–2015 amounted to AUD132.5 million representing approximately 19.24% of the nominal capital of the aggregate funds under management in 2015. This capital foregone, in a registered MIS, should have been deployed solely for the benefit of the MIS members. Other methods of tunnelling or abuse of related party transactions is to be found in the payment of directors' fees to registered organisations rather than the director personally. Seventy per cent of these fees were made to a select group of trades unions.[419]

Unhealthy cultures are not restricted to these examples. Financial advisers were previously only required to be RG146 competent,[420] a standard not requiring a tertiary qualification, industry experience or professional accreditation. These educational standards have been a considerable source of concern and only since 2007 have advisers have been required to hold professional indemnity insurance. Historically, accreditation standards have been of poor quality, poorly supervised, corrupted by cheating and plagiarism, and diminished by unacceptable cultural and ethical standards with tragic results for clients. Bizarrely in Australia, an investors' accountant is not able to provide financial advice to their client unless they are RG146 accredited, a much lesser qualification than their tertiary and professional accounting counterparts.

From 2014, partly in response to public pressure generated by systemic failure at Commonwealth Financial Planning and Macquarie Bank, enforceable undertakings by them to ASIC and subsequent public policy responses industry participants began improvements to adviser and planner educational standards. AMP, BT Financial (Westpac), MLC (National Australia Bank), and Commonwealth Financial Planning commenced the process of catching up with community expectations, a process which continues in 2018. From 2019, educational standards will include Certified Financial Planner, Chartered Financial Practitioner or Masters in Financial Planning accreditations. These will have varying standards and varying implementation dates and provide the opportunity for candidates to treaty shop for the easiest and quickest route, as they presently do to become authorised representatives.

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[417] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 336, vol 5 ch 5, 64–77.
[418] Ibid vol 4 ch 11.
[419] Morgan Begg and Simon Breheny, *Rivers of Gold: How the trade union movement is funded by industry super* (November 2017).
[420] ASIC, *ASIC Regulatory Guide – Licencing: Training of Financial Products Advisers*, RG146, July 2012).

5.6 The legislative response: Twin Peaks to Triple Peaks

Heydon sought to excise unhealthy culture. Cooper provided insight. Parliament has yet to debate its underlying causes. If it does, then it must confront the distinction between fiduciary and non-fiduciary duties and recognise the power of fiduciary law. Confused parliamentary leadership has facilitated corruption of the regulatory system.'[I]t is important [to] preserve fiduciary law … at least until a basis for expanding fiduciary law so that it incorporates prescriptive obligations is articulated rationally and accepted'.[421] The UK and Canada have had such a debate. Canada has implemented it. Australia has not:

> member and community expectations regarding conduct of officers are high and dictate that they must act in the best interest of their membership at all times and conduct their business in a transparent manner … some registered organisations do not meet their obligations.[422]

The *Fair Work (Registered Organisations) Amendment Act* and *Superannuation Legislation (Trustee Governance Bill)* seek to align the governance of registered organisations with companies and clarify their interface with APRA supervised superannuation funds. Australia's regulatory system evolves to a 'Triple Peaks' model.

The Fair Work (Registered Organisations) Amendment Bills[423] sought to amend existing legislation[424] and remedy systemic deficiencies identified by Heydon. Limited reform was enacted in December 2016.[425] It provided for an independent Registered Organisations Commissioner having powers modelled on the *ASIC Act*.[426] The intent is to 'create a stronger regulator and a real deterrence for non-compliance'[427] which is stand-alone and independent, able to manage the imbalances in power and influence. Increased civil penalties and the introduction of criminal penalties 'broadly mirror those that apply to companies and their directors'.[428]

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[421] Matthew Harding, 'Two fiduciary fallacies' (2007) 2 *Journal of Equity* 1, 25.
[422] Revised Explanatory Memorandum, Senate, Parliament of Australia, Fair Work (Registered Organisations) Amendment Bill 2014 (viii).
[423] Fair Work (Registered Organisations) Bill 2013 (Cth); Fair Work (Registered Organisations) Amendment Bill 2014 Revised Explanatory Memorandum, Senate, Parliament of Australia; Fair Work (Registered Organisations) Amendment Bill 2014 [No 2] (Cth).
[424] *Fair Work (Registered Organisations) Act 2009* (Cth); *Fair Work Act 2009* (Cth).
[425] *Fair Work (Registered Organisations) Amendment Act 2016* (Cth).
[426] *Australian Securities and Investments Commission Act 2001* (Cth).
[427] Revised Explanatory Memorandum, Senate, Parliament of Australia, *Fair Work (Registered Organisations) Amendment Bill* 2014 (xiv).
[428] Fair Work (Registered Organisations) Amendment Bill 2014 Revised Explanatory Memorandum, Senate, Parliament of Australia (ii).

It did not fully address or implement the deficiencies identified by Heydon. Directors and officers of registered organisations continue to have differing duties to those of company and superannuation trustee directors. Alignment of registered organisations with companies did proceed in respect of disclosure of conflicts of interest, auditor appointments, penalties for statutory breaches, and a requirement for officers to undertake financial training. Importantly, significant whistleblower protections[429] were added for the first time. The *Fair Work (Registered Organisations) Amendment Act* did not tackle the systemic problem of the same persons in multifunction NBFEs having to collate their duties from and align their behavioural standards with different and differing sources of law governing companies and superannuation trusts.

APRA's powers to intervene in governance related concerns are limited to 'only after the RSE licensee has contravened the law'.[430] The Superannuation Legislation Amendment (Trustee Governance) Bill[431] would provide APRA with ex ante power to direct governance arrangements for a superannuation entity.[432] It seeks alignment of 'governance in superannuation more closely with the corporate governance principles applicable to ASX listed companies'.[433] Cooper[434] suggested 'governance principles that apply to ASX listed companies formed a good starting point…'[435] ASX requires the benchmarking of corporate governance against criteria formulated by its Corporate Governance Council.[436] The Superannuation Legislation Amendment (Trustee Governance) Bill, Cooper and Murray[437] each favour reform of the *SIS Act*[438] to eliminate the equal representation model of employee and employer sponsored trustee boards. Consistent governance standards with other prudentially regulated entities, (banks and insurers) and other jurisdictions would result. Murray's preferred majority of 'independent' directors now evolved to at least one third 'independent' directors and an 'independent chair. Cooper and Murray identified the need for financial expertise and professionalism of trustee board members over the present 'equal representation' selection method,

[429] *Fair Work (Registered Organisations) Amendment Act 2014* (Cth) ch 11 pt 4A.
[430] *Superannuation Industry (Supervision) Act 1993* (Cth) s 29EB.
[431] Economics Legislation Committee, Senate, Parliament of Australia, Superannuation Legislation Amendment (Trustee Governance) Bill 2015.
[432] *Superannuation Industry (Supervision) Act 1993* (Cth) (proposed new) s 92.
[433] Economics Legislation Committee, Senate, Parliament of Australia, Superannuation Legislation Amendment (Trustee Governance) Bill 2015 1.6.
[434] Cooper, above n 43.
[435] Economics Legislation Committee, Senate, Parliament of Australia, Superannuation Legislation Amendment (Trustee Governance) Bill 2015 1.14.
[436] ASX, *Listing Rules – Corporate Governance Council Principles and Recommendations* (3rd ed, at December 2014) r 4.10.3.
[437] Murray, above n 44.
[438] *Superannuation Industry (Supervision) Act 1993* (Cth).

> free of the type of conflicts that may cause them (either intentionally or unintentionally) [to] serve the interests of the [employer and employee] sponsors, a related party or a subset of members, rather than the fund's entire membership.[439]

'It is more important for directors to be independent, skilled, and accountable than representative'.[440] Empirical research supports this view:

> trustees lack experience, training or suitable knowledge, creating the potential for not fully understanding advice that they receive from outside experts.[441] … Trustees decisions are important in how funds operate and their consequent performance[442] … trustee boards exercise better governance practices than sponsoring firm boards [of corporate superannuation funds] in terms of transparency and disclosure.[443]

Uncertainty arises from differing and vague definitions: independent is sought to be defined[444] as 'independent of ownership relating to the RSE licensee and relationships that a RSE licensee might have, with APRA having the power to arbiter "independent"'.[445] A person would not be 'independent' if: there is a direct or indirect interest of 5% or more in the ownership of the RSE; has been an executive officer; has had a business relationship; or has been a director or executive officer of a large employer related to the fund.[446] This restricts the pool of competent people from which to draw trustee board appointments where there is 'a serious problem in the culture of boards of Australia: the tiny gene pool from which directors are recruited'.[447] These issues of independence are not resolved, open to manipulation, and reflect practical difficulties of providing for all possible situations in statute. Similarly, there is confusion as to the meaning of 'best interests of the beneficiaries'.[448]

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439 Economics Legislation Committee, Senate, Parliament of Australia, Superannuation Legislation Amendment (Trustee Governance) Bill 2015 2.5.

440 Murray, 44, 135.

441 Thi Thuy Chi Nguyen, Monica Tan and Marie-Anne Cam, 'Fund governance, fees and performance in Australian corporate superannuation funds a non-parametric analysis' (2012) 11(2) *The Journal of Law and Financial Management* 2, 7.

442 Ibid 18.

443 Ibid.

444 *Superannuation Industry (Supervision) Act 1993* (Cth) (proposed new) s 87.

445 Ibid s 88.

446 Economics Legislation Committee, Senate, Parliament of Australia, Superannuation Legislation Amendment (Trustee Governance) Bill 2015 2.16.

447 Thomas Clarke, Submission to Economics Legislation Committee, Senate, Parliament of Australia, Superannuation Legislation Amendment (Trustee Governance) Bill 2015 2.11.

448 Cooper, above n 43, pt 2 ch 2, 47.

5.7 A '*Bitter Harvest*':[449] The scale of failure of Australian agribusiness MIS

Cooper inspired reform of superannuation entities has not been matched in MIS: '[m]arket failure on such a scale that regulatory intervention is needed to remedy the shortcomings':[450]

> in Australia, where the law has badly lagged behind commerce, and the use of the trust as a surrogate company has become entrenched … paradigm shifting reform [CAMAC's SLE proposal] … might be regarded as revolutionary rather than evolutionary and would inevitably spark ideological objection and lengthy debates. It would be exposed to the vicissitudes of the legislative and political process … a battleground on which various stakeholder and interest groups…campaign to influence the process in their favour.[451]

Hindsight is insightful: agribusiness MIS have been extensively reviewed and analysed.[452] Leverage (sometimes double or triple leverage) compounded by full recourse loans, poor financial advice, breaches of general law fiduciary duty, failures in disclosure (real and imagined),[453] mismatch of investor literacy with the financial products disclosure, perceptions of government endorsement (ATO financial product rulings), ethics and integrity deficiencies in financial advice, financial product selling, and research house expert reports provided to vulnerable retail investors are recurring themes. 'Australia's financial services regulatory regime, with its focus on disclosure, has not served Australian investors well and has not provided a reasonable level of consumer protection'.[454] Investor vulnerability to predatory lending included lending to finance recurring MIS management fees, often from related parties of the RE, compounding the original debt. These loans are exempt from the responsible lending provisions of the NCCP.[455] Falsified or unsigned documents with power of attorney to the RE[456] continued despite warnings from the ASIC.[457]

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[449] *Bitter Harvest*, above n 296.
[450] Ibid ch 8, 108.
[451] D'Angelo, above n 231, 259.
[452] ASIC, Submission to PJC on Corporations and Financial Services, Parliament of Australia, *Inquiry into Agribusiness Managed Investment Schemes* (July 2009); Australian Government, CAMAC, *Managed Investment Schemes*, above n 229; Australian Government, CAMAC, *The establishment and operation of managed investment schemes*, above n 253; ASIC, Submission to Senate Standing Committee on Economics, Parliament of Australia, *Inquiry into forestry managed investment schemes*, above n 242.
[453] *Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (in liq)* [2014] VSC 516; *Woodcroft-Brown v Timbercorp Securities Limited (in liq)* [2011] VSCA 284.
[454] *Bitter Harvest*, above n 296, rec 18.
[455] *National Consumer Credit Protection Act 2009* (Cth).
[456] Australian Government, CAMAC, *The establishment and operation of managed investment schemes*, above n 253, 18.
[457] ASIC, *MoneySmart*, <*https://www.moneysmart.gov.au/*>.

Deficiencies in financial literacy lead directly to reliance on others, including financial advisers. Despite the FoFA reforms, there is no statutory fiduciary duty to clients imposed on financial advisers as originally proposed by Lindgren in 2010.[458] The FPA (in respect of Trio) believe,

> few of the *FoFA* regulatory enhancements will have any impact on the prevention of future events … they have missed the opportunity to engage in a reform debate that would deliver transparent markets and product safety that would benefit all Australians, ultimately failing to deliver the effective consumer protection reform that *FoFA* promised,[459]

arguing FoFA would only assist two of the 17 problems identified: conflicted remuneration and ASIC enhanced powers to award and terminate AFSLs.[460] FPA supported the extension of the statutory best interest duty to product manufacturers, fund managers, research houses, and all AFSL holders. This is consistent, [461] but lesser duty than UK reform proposals to quality assure the investment chain by categorising all participants as fiduciaries.

Investor reliance on trust in and liking for their adviser in a regulatory environment of prioritisation over prohibition is dangerous if the adviser is not a fiduciary. Lack of prohibition allows for the return of incentive based fee structures with informed consent. 'The Committee cannot put a figure on the number of people who have suffered because of the inappropriate product promotion of MIS and the accompanying poor financial advice'.[462]

Confusion of what investors own or have rights to is rife, particularly in common enterprise MIS. Despite have an RE (being a trustee), general law trust principles in these MIS are subsumed by a complex series of contracts, sometimes with the RE having a power of attorney over the investor's contractual interest. Investor capital is aggregated into RE working capital, not used discretely. In many cases involving REs with multiple MIS, subscribed capital is intermingled, assisting marketing to future investors. Profits have been brought forward into earlier years inflating that reported accounting result. Later investors support the MIS of earlier investors: 'a Ponzi outcome of collapse is likely',[463] the result being that these MIS collapsed when new capital subscriptions failed to

[458] Lindgren, above n 106, 435; see especially, *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth); *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth).
[459] Australian Government The Treasury, *Review of the Trio Capital Fraud*, above n 139, 101.
[460] Ibid.
[461] *Bitter Harvest*, above n 296.
[462] Ibid ch 6, 83.
[463] Christine Brown, Colm Tussler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure' (2011) *The Finsia Journal of Applied Finance* 11.

eventuate and where the RE was not sufficiently capitalised to continue to operate the MIS. 'Such managed investment schemes should not be mistaken for real businesses'.[464]

Wallis' third principle: financial literacy has 'got to get aggressive,[465] becoming a 'standing item on the COAG agenda'.[466] Financial literacy is not restricted to strict notions of competency in various techniques of financial analysis: it should also mean thorough microeconomic business planning, its commercial robustness, and the suitability of that outcome to types of investors. In Australia, this is consistently missing as a disclosure standard. 'At the basic, fundamental economic level, paying three or four times the value of productive farmland to plant a commodity crop on should send warning bells…'[467] 'MIS generated investment was not based on sound long term strategic investment planning but primarily motivated by tax incentives, which caused significant distortions within the markets in which they operated'.[468]

ASIC does not have its previous financial product intervention powers, despite these being recommended by Murray.[469] Reinstatement requires ASIC to have additional professional competencies to enable it to give effect to the statutory intent of disclosure.[470] None of the more recent disclosure benchmarks require detailed business planning in financial product offer documents issued by financial product manufacturers. Whilst ASIC has moved in this direction,[471] adoption of IOSCO principles in Australian regulation would further its implementation,[472] and reduce foreign investor perceived risk of Australian collective investments.

5.8 Mind the Gap: How can this be?

A reasonable question for the investing public. Is ASIC *Fit for the Future?*[473] ASIC performs adequately administratively, but is weak strategically. This conclusion stems from analysis of five themes: governance, expectations gaps, internal focus, reactive culture, and 'future proofing'. The

[464] *Re Environinvest Ltd (No 4)* [2010] VSC 549 (Judd J).
[465] *Bitter Harvest*, above n 296, rec 4.
[466] Ibid rec 4.
[467] Ibid ch 13, 195.
[468] Ibid ch 13, 198.
[469] Murray, above n 44, 206.
[470] *Corporations Act 2001* (Cth) s 1013D.
[471] ASIC, *Research report providers: improving the quality of investment research* (Regulatory Guide 79, December 2012).
[472] IOSCO, *Statement of Principles for Addressing Sell-side Securities Analysts Conflicts of Interest* (September 2015).
[473] Karen Chester, Mark Gray and David Galbally, *Fit for the future A capability review of the Australian Securities and Investments Commission – A Report to Government* (Report, December 2015).

> expectations gap is 'much greater than expected'…[474] external stakeholders are not fully aware of the limits of what ASIC can and should do. This is demonstrated in the tendency for public reaction and criticism against ASIC where there is market failure or losses … and warrants immediate attention to improve clarity over ASIC's mandate.[475]

Expectations gaps are measured quantitatively and reported as the percentage variance between ASIC's own expectations and those of an external stakeholder sample. It does not measure the variance between stakeholder expectation of ASIC and stakeholder views of ASIC practice. Nor does it comment on the absolute data: these give rise to significant concerns as to the efficacy of ASIC. These omissions are unfortunate since of the 25 measures of alignment/misalignment, only three are reported as having more than a 50% expectation of positive performance. These are market transparency, reliable company financial records and reasonableness of licensing costs (now reformed). In the reported measures, the greatest misalignment between ASIC's view of itself and its stakeholders views are: proactivity in identifying risk, strategic thinking, responsiveness to emerging risks, use of resources, leadership capacities, and the compliance burden, the latter being supported by qualitative research.

The expectations measurement of financial literacy results in an alignment of ASIC and stakeholder views (external stakeholders 21%, ASIC 18%, variance -3%) with the review concluding that ASIC

> does lead international best practice in advancing broad consumer financial literacy,[476]… while the overall financial literacy strategy is comprehensive and world best.[477]

This conclusion needs to be challenged. The absolute data (rather than the variance data) demonstrate that there is an acknowledged problem with financial literacy in Australia. Education and guidance are the least intrusive and most cost effective tools available to ASIC.[478] Misinterpretation of ASIC's role also leads to expectations gaps in the award of AFSLs, the meaning of MIS PDS registration, expectations of fit and proper, and enforcement actions.

ASIC's mandate is to 'promote the confident and informed participation of investors and consumers in the financial system …'[479] It has not achieved this outcome. Reform is imperative commencing with a redefined charter and amendment of the *ASIC Act*. Governance reform to a two tier board

[474] Ibid 7.
[475] Ibid 9.
[476] Ibid 99.
[477] Ibid 115.
[478] Ibid 114.
[479] *Australian Securities and Investment Commission Act 2001* (Cth) s 1(2).

structure is proposed and consistent with Uhrig,[480] since rejected by ASIC. Governance reform is generated by the breadth of ASIC's mandate and its reactive, issue based posture, 'not fully replicated by any other conduct regulator globally',[481] or by APRA and ROC.

There is evidence that government lacks insight into ASIC's need for governance and culture reform.[482] It is not clear that 'underfunding' has been a problem,[483] but there are dissenting views.[484] Revenue has been reformed, but governance, financial allocations and human resources must follow function. That has not been achieved. Behavioural economics research casts substantial doubt on new ASIC funding proposals. These are likely to prove costly to its clients and not address the underlying systemic problem. '[S]uch regimes increase governance costs without reducing the residual governance problems.'[485]

5.9 Community expectation — Responsive Regulation

Cooper and Heydon provide the insight: fiduciary duty as the antidote to unhealthy culture, deficiently codified in superannuation supervision; in other entities, subsumed by complex and incomplete statutes. Diffusion of regulatory tools must reflect this reality and address the huge disparity in the number of entities for which ASIC, APRA, and the ROC are the responsible regulators.

Community expectation that ASIC can police every commercial transaction is unaffordable, undesirable and unachievable. ASIC's responsibilities include inter alia more than 2.1 million companies, 490 REs, 861 custodians, more than 2000 trustee entities, more than 5000 financial advice entities with 24 323 advisers.[486] This mandate is proposed to be extended.[487] It is 'not feasible to contract [ex ante] for every contingency'.[488] The *Corporations Act* attempts to achieve that to the frustration of the judiciary as Chapter 4 illustrates. Chapter 3 provides the empirical basis for ASIC's future enforcement priorities.

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[480] Uhrig, above n 99.
[481] Chester, Gray and Galbally, above n 473, 34.
[482] Australian Government, *Proposed Industry Funding Model for the Australian Securities and Investments Commission* (Proposals Paper, November 2016) 4.
[483] Chester, Gray and Galbally, above n 473, 13.
[484] See especially Pamela Hanrahan, 'ASIC and managed investments' (2011) 29 *Companies and Securities Law Journal* 297 and Dimity Kingsford Smith, 'A harder nut to crack? Responsive Regulation in the financial services sector' (2011) 44 (3) *University of British Columbia Law Rev*iew 702.
[485] Sven Hoeppner and Christian Kirchner, 'Ex Ante versus Ex post Governance: A behavioural perspective' (2016) 12(2) *Review of Law and Economics* 249.
[486] ASIC, *Proposed Industry Funding Model for ASIC*, above n 272.
[487] Australian Government Productivity Commission, above n 324, pt 17.
[488] Hoeppner and Kirchner, above n 485, 232.

CHAPTER 3: THE EVIDENCE, CAUSE AND EFFECT 1981-2018

An holistic empirical analysis

> Many reform areas have lagged for … a lack of a specific enough analytical framework and appropriate data with which to evaluate the possible costs and benefits of various regulations and their interactions, making reform steps consequently unclear; and a lack of practical methods of implementation…[1]

This chapter provides that analytical framework. It provides insightful data in several dimensions which are indicators and tools to predict ex ante investment legal risk, hitherto ex post. This framework identifies previously unknown factors and the basis for strategic and tactical reform.

3.1 Non-Bank Financial Entities (NBFEs)

This empirical analysis quantifies the financial losses incurred by investors in the Australian NBFE sector through the period described in Chapter 2. Loss is defined as complete or partial loss of funds, impairment, or risk of complete or partial loss. Dates of these failures are estimated from the date of administrator or provisional liquidator appointments or the date of the first court judgment (including directions hearings). Malfeasance may have commenced at earlier dates but remained undiscovered or unreported. The sample includes failed NBFEs from 1981 to 2018, but excludes those frozen as a result of the GFC in 2008/9 and subsequently unfrozen.

The categories of NBFE in the sample include: financial products and financial services conglomerates; investment banks, government rescued entities; insurance entities; hedge funds; Managed Investment Schemes (MIS) and debenture trusts (real estate); MIS (forestry and agribusiness); companies with similar agribusiness models to MIS; MIS (infrastructure); securities brokers and securities leveraged lending; securities trading platforms; wealth, financial planning and funds management firms and workers entitlement funds (being exempt MIS). NBFEs in the Australian superannuation industry include industry funds, retail funds, corporate funds, and SMSFs. There is a small (by number) government superannuation sector.[2]

[1] Stijn Claessens and Laura Kodres, 'The Regulatory Responses to the Global Financial Crisis: Some uncomfortable questions' (Working Paper No 14/46, International Monetary Fund, March 2014) 4.
[2] Eg Future Fund, Queensland Investment Corporation.

3.2 Methodology

'[I]n Australia, comprehensive case data regarding filed cases or settled cases are not available'.[3] A review of published senior court judgments[4] of NBFE cases (n=320, of which 199 have authoritative primary empirical data) 1981-2018 (a 38 year investment period) forms the basis of this analysis. Many cases involved multiple proceedings. There is no comprehensive electronic search system which captures the reasons for these senior court judgments and reliance on case catchwords can be misleading. A reading of the judgments is required. These hand-collected data from the content of the judgments are supplemented by data sourced from other authoritative sources including Royal Commissions, Parliamentary Inquiries, ASIC and APRA documents, liquidators' reports, and selected third party publications. Magistrates, District and County Court judgments are mostly excluded from the sample. Many of these are professionally unreported. The sample excludes unreported private ex-curial proceedings but does include cases where enforceable undertakings are an outcome of civil proceedings. Cases are grouped where related parties appear in similar judgments, but separated where a related party entity is involved in proceedings involving different issues of law or a different business type. For instance, a RE of one or more operational MIS may have a related party finance company. These are treated as separate cases, but multiple MIS with the same RE are treated as one case. This typology does not diminish the reporting of issues of law in Table 3.22. It does reduce the number of discrete incidences (there are many cases with similar multiple incidences in the same case), but does not reduce the number of investors or the quantum of their losses.

There is a lack of consistency in court judgments in the reporting of empirical data. Inference is required in some cases. Where there is no reliable primary source, no assumptions have been made. Financial press reports are not sources. So it is likely that the data reported below are underestimates of the true position. Nonetheless, empirical and legal trends are clear. Care has been taken to avoid double counting of empirical data, for instance where a replacement RE becomes trustee for a MIS. The analysis identifies the primary legal issues addressed in the judgments, their legal effect, estimated number of investors and quantum of their losses and impairment, remediation, entities associated with each case, the responsible regulator, date of first reporting, and their legal citation. This data is summarised below. There is no other single holistic authoritative source. The primary data is in spreadsheet format. Much of the remedial data is publicly unreported, some is confidential.

[3] Jenifer Varzaly, 'The Enforcement of Directors Duties in Australia: An Empirical Analysis' (2015) 16 *European Business Organisation Law Review* 281, 300.
[4] HCA, FCAFC, FCA, NSWSC, NSWCA, VSC, VSCA, QSC, QCA, SASC, SASCA, WASC, WASCA. There are a very small number from lower courts.

What is reported illustrates a low rate of recovery.[5] This is supported by this analysis with an average 4.24 % recovery or remediation across the sample. There are some exceptions where recovery is significantly higher: these merely serve to emphasise the abysmal rates of recovery elsewhere, demonstrating that Australia's ex post regulatory posture does not serve investors well.

3.3 Summary of empirical data

The following tables summarise the empirical data by type of NBFE with Tables 3.17 and 3.21 reporting the aggregate data. The tables include the number of NBFEs in the sample, the number for which there is authoritative source data, investor funds lost or at risk of permanent impairment, and the number of investors or beneficiaries adversely impacted. In some cases, for example Table 3.2, government is the sole shareholder notwithstanding that prior to government control, many thousands of investors have been involved. In some superannuation entities (Table 3.13) a consortium is reported by its membership numbers, not by the number of investor beneficiaries in the consortium funds membership.

TABLE 3.1 Financial services and financial products conglomerates

This sample includes vertically integrated multifunction NBFEs.

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
16	**15**	**14,731**	**112,634**

TABLE 3.2 Government rescued financial entities

During the sample period, government intervention has resulted in control.

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
5	**5**	**6,502**	**7**

[5] Varzaly, above n 3, 302. Qualitative research supports this analysis.

TABLE 3.3 Insurance entities

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
14	6	957	69,292

TABLE 3.4 Hedge Funds

Hedge funds are pools of capital, historically lightly regulated, mobile capital. Large quantities of hedge fund capital can rapidly be brought to bear opaquely on specific investment strategies globally. The owners of the capital, the investors, are typically the family offices of high net worth individuals, family trusts, and investment banks. Over time, they were joined by superannuation funds, retail investors, local government, and university endowment funds.

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
4	3	738	1,745

TABLE 3.5 Managed Investment and Debenture Schemes: real estate

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
81	56	10,423	291,517

TABLE 3.6 Managed Investment Schemes: Forestry & Agribusiness

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
33	23	6,826	169,590

TABLE 3.7 Investment companies with similar business models

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
6	6	178	2,324

TABLE 3.8 Managed Investment Schemes: Infrastructure

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
6	2	2,924	850

TABLE 3.9 Securities broking & leveraged lending

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
9	8	1,105	2,304

TABLE 3.10 Securities trading platforms

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
18	12	226	5,647

TABLE 3.11 Wealth Management, Financial Planning, and Funds Management

This sector is pervasive, often under-skilled, sometimes conflicted, and has seriously impacted the financial standing of many of its clients.

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
72	43	4,018	423,741

TABLE 3.12 Retail superannuation funds

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
3	3	372.50	31,076

TABLE 3.13 Industry superannuation funds

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
19	5	2,918	291,458

TABLE 3.14 Workers Entitlement Funds (WEFs)

WEFs are controlled by related party registered organisations, usually structured as exempt MIS.

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
7	2	146	24,730

TABLE 3.15 Other superannuation entities

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
8	3	105	1,370

TABLE 3.16 Finance companies

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
16	7	81	487,323

Other entities

Other NBFEs not part of the sample include film schemes, property timeshare schemes, actively managed strata title schemes, contributory mortgage schemes, litigation funders, betting schemes, aged care and retirement accommodation, and management rights.[6]

TABLE 3.17 Aggregate data

No. NBFEs in sample	No. NBFEs with authoritative data source	Funds lost or permanently impaired (AUD mill)	No. investors or beneficiaries impacted
320	**199**	**52,251**	**1,915,608**

3.4 Table of Cases

The individual cases and sources from which empirical data have been sourced are cited in Appendix 2.

3.5 A national productivity issue: the law matters

NBFE investment is largely at the margin, being venture financing not provided by mainstream prudentially regulated banks. Whilst superannuation investment is prudentially regulated, interest group pressure is publicly applied to trustees to deploy capital in favoured ways, sometimes by related parties. Financing at the margin should earn a risk adjusted return. A proxy for the return expected is the ASX long term all accumulation index (ie dividends are reinvested). This is the risk adjusted return NBFE investors should have expected if capital had been successfully deployed in accordance with disclosure documents. That capital has not been successfully deployed in the cases cited. Much has been lost in deadweight costs (on investment and insolvency), with the balance lost, earning zero or considerably less than forecast. These are direct losses only. They do not account for indirect, consequential, and social losses or the increased risk aversion of other investors. Table 3.18 quantifies the adverse economic impact. This data is illustrative — it is not definitive of the complete universe of NBFEs. It relies on extraction of empirical data from the unstructured data sets in the sample.

[6] Alan Jessup, *Killing Bambi – Improving the effectiveness and efficiency of the legal and regulatory framework for protection of retail investors investing in collective investment schemes* (SJD thesis application to University of Sydney, 2012); Alan Jessup, *Managed Investment Schemes* (Federation Press, 2012) 30. See also ASIC, 'How to register a managed investment scheme' (26 October 2017) <http://www.asic.gov.au/for-finance-professionals/fund-operators/establishing-and-registering-a-fund/how-to-register-a-managed-investment-scheme/>.

Hitherto, comparative conclusions have been largely anecdotal and ad hoc. Table 3.18 attempts to begin to quantify the social and economic costs of present Australian law.

TABLE 3.18 Estimated impact of cumulative investor losses on Australian productivity[7]

GDP computation	AUD billion
Accumulated investor losses	52,251
All Ords All Accum Index LT return 15%	7,838
Nominal Australian GDP 2016–17	1,693,452
Loss % nominal GDP	0.4628%
Nominal Australian GDP growth 2016–17	2.00%
Loss % nominal GDP growth	23.14%

The aggregate adverse consequences are equivalent to over 0.46% of 2016–17 nominal Australian GDP. This capital should have been generating economic activity each and every year since investment up to the date of capital return and subsequent reinvestment. Had the capital been properly deployed in accordance with disclosure documents, it implies that the national economy could have grown 23.14% faster than it did, driven by entrepreneurial NBFE financing. The essential insight is that the cumulative misallocation of capital in aggregate — the opportunity cost — causes lower economic growth. This is particularly so because NBFE financing is at the margin — it finances projects that would not otherwise occur.

This has considerable economic costs for Australian business. It is a national productivity issue and is a direct result of systemic failures in the Australian regulatory regime. Risk aversion and reluctance to invest in NBFEs is a feature of the present investment landscape. Paucity of marginal sources of capital for ventures leads directly to capital constraints in the more entrepreneurial parts of the economy. It explains the paucity of available collective investment options, the distrust of mandatory superannuation and the preference for direct investment into real property, particularly by self-managed superannuation funds (SMSFs) and discretionary trusts.

Most investors are in the 25–64 age cohorts (being a 40 year investment period). Losses thus fall disproportionately on them. A large proportion of that potential cohort is limited to direct investment in compulsory non-SMSF superannuation, home mortgage, rental mortgages, and bank deposits. By inference, the investing cohort is smaller than the aggregate suggests. The percentage of investors affected in aggregate sets the lower bound which assumes 100% of the aggregate NBFE investing

[7] Australian Bureau of Statistics, *Key Economic Indicators* (Series 1345.0, 2017).

cohort actually invests. Hence the proportion suffering adverse impacts is likely to be significantly larger than 15.87%.

Much NBFE investing is through discretionary (family) and SMSF trusts, a lower proportion of investors than the aggregate cohort. Many of these operate through custodians or nominees. Many will have multiple investments, multiple investment structures, and will have been exposed in more than one instance. That is why the data is illustrative, not definitive. A definitive empirical data set demands transparency in beneficial ownership. This does not presently exist and cannot necessarily be extracted from the judgments. It also demands analytical resources which only the largest custodians or ASIC and APRA could have. Indeed, it may be beyond human intervention and, should transparency occur, require the use of cognitive, artificially intelligent digital robots to source, analyse, and report on the data. This data uses the number of SMSFs and Australian resident trusts as a proxy — it seeks to do nothing more than provide a basis for assessing the macroeconomic and social impacts. The essential insight is it provides a methodological framework for when transparency of diffuse securities ownership and the application of artificial intelligence in the law allow.

TABLE 3.19 Percentage of investing population directly affected[8]

Investing population analysis		
Individuals	**male**	**female**
25–54	4,783,473	4,626,603
55–64	1,321,246	1,341,329
	6,104,719	5,967,932
Total possible investing population	12,072,651	
# Investors lost capital	1,915,608	
% of total possible investing population	15.87%	
Corporate investors		
# SMSF's	596,517	
# SMSF members	1,130,000	
# Discretionary trusts	642,000	
Total corporate investing structures	1,238,517	
Total estimated members	1,772,000	
# Investors lost capital	1,905,608	
% of total possible investing population	107.54%	

[8] Central Intelligence Agency, *World Factbook* (CIA, 2015) <www.indexmundi.com/australia/age_structure.html>; Australian Prudential Regulation Authority, *Statistics Annual Superannuation Bulletin* (June 2017) 10.

If individual discretionary and SMSF trust investors are used as a proxy, the proportion directly affected rises to 107.54%. So the range is 15.87% – 107.54%. Some investors use multiple structures and some invest personally outside of these structures which accounts for the statistical oddity in the upper bound data. The percentage accorded these investing structures is a proxy for the upper bound.

Reduced propensity for NBFE investment by those not suffering direct losses would further increase this proportion. This implies considerable disruption of the NBFE capital markets. The costs of disruption have been quantified elsewhere with estimates of economic loss having a multiplier of 18 times, much of it attributed to 'unmanaged conflicts of interest'.[9]

3.6 Hypothesis testing by qualitative research

Confidential qualitative research interviews have been conducted with senior professional and investment persons (n=28) in each of Sydney, Melbourne, and Brisbane. Each person was questioned using open ended technique from a prepared list designed to identify problematic issues requiring reform. Table 3.20 summarises the results of those interviews. Responses fell into 51 categories with significant geographic variances. Top quartile data are the averages across the three cities. Of the 43 proposed reform options proferred, only one had significant support (50%), being the imposition of inalienable fiduciary duty in the investment chain, support being greatest from Sydney respondents (70.59%). This result is significant given Sydney's prominence in Australian funds management. Melbourne respondents (n=5) had unanimous criticism of the prevalence of related party transactions. Their responses appear to be influenced by their proximity to the industry superfund sector, of which there was excoriating criticism. However, it is small sample size, but supports analysis reported in Heydon.

[9] Minouche Shafik, 'From "ethical drift" to "ethical lift" ― Reversing the tide of misconduct in global financial markets' (Panel Discussion at the Federal Reserve Bank of New York Conference on Reforming Culture and Behaviour in the Financial Services Industry, 20 October 2016) 2.

TABLE 3.20 Qualitative research results from Sydney, Melbourne, and Brisbane

Top Quartile	**% Sample**
Related party transactions	60.71%
Financial regulation in isolation: accretive tinkering: need trust principles	57.14%
Intrusion of 'black' letter law	50.00%
Conflicts of interest - related trustees & investment managers/promoters/advisers	50.00%
Box ticking regulation by ASIC	46.43%
Financial planning not a profession	46.43%
Appearances of probity only: self interest rules	39.29%
Australian financial sector not internationally competitive in structure or fees	35.71%
Ineffective leadership at ASIC/ wrong leadership motivations	35.71%
Smart lawyer manipulation of complex 'black letter' law	32.14%
Financial planners should have unqualified best interest duty to client	32.14%
Boards need more independent minds	32.14%
Adviser financial literacy often flawed	32.14%
Most favoured reform options	
All to be subject to fiduciary principles	50.00%

3.8 Systemic causes of failure identified in the empirical legal analysis

3.8.1 Methodology

The senior court judgments have been analysed using the terminology in the judgments. That terminology is not always consistent. This analysis is summarised in Table 3.22 'Issues of Law', ranked by absolute incidence of the issue and expressed as a percentage of the total incidences in the sample (917 incidences) from 320 cases. Many cases involve multiple breaches of multiple statutes. The primary *Corporations Act* provisions are cited indicatively to clarify the descriptors, but there are often multiple breaches of that statute. Other oft quoted statutes include the *Australian Securities and Investments Commission Act*, *Superannuation Industry (Supervision) Act*, *Australian Competition and Consumer Act* (formerly *Trade Practices Act*), and *National Consumer Credit Protection Act*.

TABLE 3.21 Summary by category, funds lost/impaired and investors impacted

NBFE category	# NBFE's with authoritative empirical data	Funds lost/permanently impaired AUD million	# beneficiaries/investors impacted
Financial conglomerates	15	14,731	112,634
Government rescued entities	5	6,502	7
Insurance entities	6	957	69,292
Hedge funds	3	738	1,745
MIS/debenture schemes real estate	56	10,423	291,517
MIS forestry & agribusiness	23	6,826	169,590
Companies similar business model	6	178	2,324
MIS infrastructure	2	2,924	850
Securities broking & leveraged lending	8	1,105	2,304
Securities trading platforms	12	226	5,647
Wealth management/financial planning	43	4,018	423,741
Retail superannuation	3	372	31,076
Industry superannuation	5	2,918	291,458
Workers entitlement funds	2	146	24,730
Other superannuation entities	3	105	1,370
Finance companies	7	81	487,323
TOTAL SAMPLE	**199**	**52,251**	**1,915,608**

Commercial issues including mismatch of assets and liabilities and leverage (common in MIS) are not included in the analysis but are additional non-legal causes of NBFE failure. In many cases, particularly in real estate MIS, financial planning, superannuation and finance companies, large numbers of investors are impacted as a result of one incidence. There are comparatively few discrete incidences in financial literacy. This does not mean an absence of systemic failure. On the contrary, Table 3.22 demonstrates otherwise: it is a function of the number of discrete incidences reported by typology in the judgment which determines their empirical impact. Financial literacy cases include those involving informed consent and contributory negligence. Arguably, the prevalence of lawlessness in unlawful unregistered MIS, egregious behaviour in registered MIS, and unlicensed financial services businesses is a financial literacy category since the investing community should be knowledgeable enough to identify and avoid such cases. That is not so and the data has not been treated so in this analysis.

Similarly, where one entity the subject of judicial review operates multiple investment schemes (often a large number of registered and unregistered schemes), this is reported as one incidence of the issues in that judgment. Cases involving the antecedents of the *Corporations Act* (*Corporations Law*, State *Companies Codes*), and ASIC (State Corporate Affairs Commissions and Australian Securities Commission) are included in the equivalent modern *Corporations Act* provision. Incidence of breaches of fiduciary duty are likely to be understated because many of the entities are not regarded as fiduciaries in Australian law and, if they are, have the legal ability to contract out of that relationship.

TABLE 3.22 Legal matters raised in the judgments

Legal matters raised in the judgments	# by incidence	% cases
Related party transactions CA s 191	76	23.97%
Misleading & deceptive/unconscionable conduct CA s 1041H, AA s 12DA, ACCA s 52	71	22.40%
Fraud	53	16.72%
Breach of fiduciary duties (statute & general law) CA s 601FD	51	16.09%
Financial services business CA s 911A/ financial advice CA s 781/ dealing CA s 780 without AFSL	47	14.83%
Breach of good faith, proper purpose, best interest duty CA ss 181-184, 961 (FoFA)	45	14.20%
Conflicts of interest & duty CA s 191	45	14.20%
Unregistered unlawful MIS CA s 601ED	43	13.56%
Insolvency of NBFE (Incl RE/trustee)	33	10.41%
Judicial/Court directions	32	10.09%
Failure to properly disclose material matters CA s 191	32	10.09%
Untrue/defective/misleading prospectus/PDS disclosure CA s 728	26	8.20%
Improper financial advice	24	7.57%
Uncommercial/unconscionable transactions	23	7.26%
Breach of trustee &/or RE duties (uncategorised)	22	6.94%
Corporate governance failures/director competence/fit & proper	19	5.99%
Dishonesty/lack of integrity CA s 601FC,FD	18	5.68%
Knowing assistance, receipt, accessorial liability, *Barnes v Addy*	17	5.36%
Breach of care & diligence duty CA s 180	15	4.73%
Reckless conduct	14	4.42%
No lawful offer document CA s 1012,1013	14	4.42%
Improper/ misleading accounting treatments	13	4.10%
Ponzi scheme CA s 461	13	4.10%
Negligence	12	3.79%
Failure to properly keep books and records	12	3.79%
Breach of auditor duty	11	3.47%
Falsification of documents	11	3.47%
Inability to provide informed consent	11	3.47%
Public interest	10	3.15%
Spurious valuations/no valuations	9	2.84%
Continuous disclosure obligations/ ASX listing rules	9	2.84%
Trust Acts (NSW, Qld, WA) ss 22, 59-63, 96	8	2.52%
Breach of sole purpose test (superannuation) SIS Act s 62	7	2.21%
Jurisdiction	7	2.21%
Restraint on travel/passport forfeiture CA s 1323	6	1.89%
Rescission/ ab initio	6	1.89%
Lack of fully informed consent	5	1.58%
Constructive trust	5	1.58%
Insider trading, market rigging, CA s 1043A	5	1.58%
Privilege	4	1.26%
Tortious liability	3	0.95%
Briginshaw standard	3	0.95%
No replacement RE/trustee	3	0.95%
Court appointed investment manager	2	0.63%
Calderbank offers	2	0.63%
Improper custody of assets	2	0.63%
Costs reasonable	2	0.63%
Dividends out of capital	2	0.63%
CA ss 601NF, 1325,	2	0.63%
Inaccurate forecasting disclosure	2	0.63%
Breach of CA s 177	1	0.32%
Breach of CA s 283DA	1	0.32%
Breach of enforceable undertaking	1	0.32%
Unauthorised reduction of capital	1	0.32%
Chose in action	1	0.32%
CA s 674	1	0.32%
Inducement	1	0.32%
CA ss 249D, 249N	1	0.32%
Self dealing	1	0.32%
Related party power of attorney	1	0.32%
Total incidences in 320 cases	*917*	

3.8.2 Interpretation of data

This data has then been ranked as top decile and top quartile prevalence of the legal issues identified in the judgments. These are the top 10% and 25% issues of law identified in the judgments. For example, related party transactions recur in 22.16% of the top 10% of issues of law addressed in the judgments.

TABLE 3.23 Prevalence of issues of law as top decile and top quartiles of sample

Issues of law	Top decile prevalence	Top quartile prevalence
	n =343 incidences	n = 623 incidencies
Related party transactions CA s 191	22.16%	12.20%
Misleading & deceptive/unconscionable conduct CA s 1041H, AA s 12DA, ACCA s 52	20.70%	11.40%
Fraud	15.45%	8.51%
Breach of fiduciary duties (statute & general law) CA s 601FD	14.87%	8.19%
Financial services business CA s 911A/ financial advice CA s 781/ dealing CA s 780 without AFSL	13.70%	7.54%
Breach of good faith, proper purpose, best interest duty CA ss 181-184, 961 (FoFA)	13.12%	7.22%
Conflicts of interest & duty CA s 191	13.12%	7.22%
Unregistered unlawful MIS CA s 601ED		6.90%
Insolvency of NBFE (Incl RE/trustee)		5.30%
Judicial/Court directions		5.14%
Failure to properly disclose material matters CA s 191		5.14%
Untrue/defective/misleading prospectus/PDS disclosure CA s 728		4.17%
Improper financial advice		3.85%
Uncommercial/unconscionable transactions		3.69%
Breach of trustee &/or RE duties (uncategorised)		3.53%

The primary issues of law have then been grouped into legal causes of systemic failure. Some of these groupings include multiple issues of law, others which are discretely identified are reported as in Table 3.22. For example, dishonesty includes direct judicial references to dishonest conduct, but also includes judicial references to spurious valuations, lack of integrity, falsification of documents, fraud, self-dealing, Ponzi schemes, inducement, insider trading, and knowing assistance. Fiduciary duties includes instances of improper use of trust assets, breaches of State *Trust Acts*, auditor duty, and constructive trust.

TABLE 3.24 Incidence of systemic failures in the Australian regulatory system

Systemic failures (by category)	# by incidence	% incidence
Dishonesty	128	15.98%
Related parties/conflicts of interest CA s 191	122	15.23%
Directors/trustee duties CA ss180-184, SISA s 62	119	15.23%
Disclosure	108	14.86%
Misleading/deceptive/unconscionable conduct CA s 1041H, AA s 12Da, ACCA s 52	94	11.74%
Fiduciary duty (statute & general law)	77	9.61%
Financial advice CA ss 780,781,911; Unlicensed/breaches of AFSL	71	8.86%
Unlawful unregistered MIS CA 601ED	43	5.37%
Governance	22	2.75%
Financial literacy	17	2.12%
Total incidences	*801*	

3.9 Predictive veracity of the empirical data

There are predictive insights to be derived from the top decile, top quartile, and systemic failures tables. Table 3.25 is a correlation analysis where the correlated incidence is greater or equal to 90% of the principal variable identified in top decile, top quartile and systemic failure tables.[10] These are not regression analyses with dependent variables. It reports incidences derived from the judgments and correlates those incidences against each of the other variables listed. 199 case analyses is a statistically substantial sample. Therefore, it a reasonable hypothesis that this empirical analysis has predictive veracity, and by inference, to non-curial cases.

TABLE 3.25 Correlation analysis of principal variables

Legal matters raised in the judgments	Variable	Recurrence % of sample	Correlation
Top decile			
Related party transactions CA s 191	1	22.16%	
Misleading & deceptive/unconscionable conduct CA s 1041H, AA s 12DA, ACCA s 52	2	20.70%	93.42%
Top quartile			
Dishonesty	1	15.98%	
Related parties/conflicts of interest CA s 191	2	15.23%	95.31%
Systemic causes - first variable correlation			
Dishonesty	1	15.98%	
Related parties/conflicts of interest CA s 191	2	15.23%	95.31%
Directors/trustee duties CA ss180-184, SISA s 62	3	15.23%	95.31%
Disclosure	4	14.86%	92.97%
Systemic causes - second variable correlation			
Related parties/conflicts of interest CA s 191	2	15.23%	
Directors/trustee duties CA ss180–184, SISA s 62	3	15.23%	100.00%

[10] For full correlation matrices, see below App 2.

The correlation matrices point to substantial systemic risk buried deeply in the governance of entities in the financial system. Remedying this risk will require substantive law reform to eliminate or ameliorate its causes. A starting point is where matrices identify a 90% greater or equal correlation between the selected variables.

Related party transactions and misleading and deceptive conduct are closely correlated (93.42%) — statistical siblings. There are high correlations between incidences of dishonesty, related parties/conflicts of interest (95.31%), breaches of directors' fiduciary and best interest duties (95.31%), and failures in disclosure (92.97%). Where there are related parties, there will be conflicts of interest with an absolute correlation with breaches of directors' duties.

Directors, regulators and investors should focus their attention on any transaction where there are related parties. A review of the complete correlation tables identifies other areas of the law requiring reform and its enforcement. This data suggest that present law, or its enforcement, is not effective.

Incidences for which ASIC alone bears market conduct responsibility account for 81.23% of the sample. A minority of cases involve superannuation entities. There are relatively few judgments in the superannuation sector. Those cited, *Commercial Nominees*, *Trio*, *Oasis*, and some workers compensation MIS all involve related party transactions and resulted inter alia in fraud, misleading and deceptive conduct, asset impairment and direct consequential losses to superannuation and MIS beneficiaries.

If the predictive qualities of this empirical data are correct, then the publicly reported cases of related party transactions in industry superannuation entities need to be thoroughly investigated by APRA, in Workers Entitlement Funds by ASIC and the ROC. There are many instances of related party transactions, conflicts of interest, questionable adherence to the sole purpose test, and payments made of questionable veracity. Such egregious behaviour blights the history of Australian MIS, as Heydon and Hayne identified, and have recurred in financial conglomerates, whether NBFEs or otherwise.

3.10 Cyclical patterns of behaviour 1981-2018

The evidence suggests that evolution of the regulation and supervision of NBFEs falls into the four distinct periods identified in Chapter 2. Many cases have resulted in judicial intervention over many years. The dates attributed in Table 3.25 are the first date of intervention by administration or court referral, not the subsequent dates of the cases as reported. Table 3.26 illustrates its cyclical nature and pinpoints the commencement of each period. New cases also recur within these cycles. The peak in 1990 is a direct result of the regulatory environment through the 1980s (Deregulation and

Entrepreneurship), its weaknesses exposed by the ASX correction of 1987 and the subsequent recession in Australia. From 2001 onwards, incidents of litigation increase as a result of a developing and more informed investment community and the advent of class actions (Disquiet). Some of these are attributable to the introduction of the *Managed Investments Act* in 1998. It significantly changed the nature of Australian collective investment scheme regulation. It facilitated the growth of the NBFE sector without providing for proper policy implementation. Regulatory and private litigation become prevalent from 2008 onwards as a direct (Reaction) to the manifest systemic failures in Australian regulation and supervision. As in 1990, the GFC in 2008/9 exposed those underlying failures, and provided cover to those seeking excuses. Subsequent years continue judicial intervention as cases are finalised, but do not of themselves provide more than tactical responses to specific legal and commercial issues (Statutes). Therefore, without substantive law reform, this historical analysis predicts that failures will continue to be exposed by a future macroeconomic event.

TABLE 3.26 Cyclical failure

Age	Year	# Cases
Deregulation/	1981	1
Entrepreneurship	1982	0
	1983	0
	1984	0
	1985	0
	1986	0
ASX correction	1987	1
	1988	0
	1989	4
	1990	10
	1991	2
	1992	1
	1993	0
	1994	0
	1995	1
	1996	0
	1997	1
Managed Investments Act	1998	5
	1999	8
	2000	2
Disquiet	2001	7
	2002	6
	2003	10
	2004	4
	2005	7
	2006	9
	2007	17
	2008	29
Global Financial Crisis	2009	26
Reaction	2010	23
	2011	9
	2012	13
	2013	17
Statutes	2014	27
	2015	14
	2016	22
	2017	9

3.11 Different Peaks: different outcomes

The primary regulators are ASIC, APRA, and the ROC, previously the responsibility of the Fair Work Commission. Other regulators include the RBA, the ASX, the ACCC, State and NZ authorities. ASIC is involved with 100% of the sample, and of itself directly regulated 81.23% of them; ASIC and APRA together (Twin Peaks) regulated 11.08% of the sample. ASIC and the ROC) regulated a further 2.15% of the sample (Triple Peaks). Despite the constant public criticism of ASIC, the data and the cases from which it is derived show ASIC to have been an active regulator. It was the plaintiff in 64.32% of the litigated cases.[11] This implies that ASIC is not resource constrained. The deficiencies in desired outcomes therefore should be attributable to other causes.

These differences are explained by the different mandates and postures of each regulator. It is tempting, but erroneous to infer that ex ante supervision provides a better investor outcome than ex post market conduct regulation. ASIC's responsibility nationwide extends broadly to more than 2 million entities and much of their commercial activity. ASIC has the broadest mandate of any comparable regulator. APRA has a far fewer number of entities to supervise. Nonetheless, egregious behaviour has occurred in its supervised entities and within its different statutory constructs.

TABLE 3.27 Scope of regulator activity in the NBFE sector

REGULATOR		
ASIC/ASC/CAC	264	81.23%
ASIC/ QLD OFT	5	1.54%
NZFMA	4	1.23%
APRA/ISC/ASIC	36	11.08%
ASIC/ASX	1	0.31%
FWC/ASIC	7	2.15%
ASIC/ATO	7	2.15%
ACCC	1	0.31%
Total interventions	*325*	

3.12 Is lawlessness endemic in Australian financial services and financial products markets?

Unlicensed unlawful provision of financial services, financial products, and financial advice and unlawful unregistered MIS account for 14.23% of the incidences of systemic failure (Table 3.24) and 35.96% of all incidences in the sample (Table 3.22). Some of these incidences relate to the same case.

[11] See below App 3.

These are both top quartile prevalence behaviours over the period of the sample unprevented either by law enforcement or disciplines imposed by the investing public based on sound, unconflicted financial advice. Caveat emptor trumps fiduciary principles and statute. To illustrate:

> The schemes are generally designed so that all the investors ever receive are the pieces of paper constituting the agreements ... promoters design increasingly more sophisticated schemes in attempts to circumvent the laws.[12]

Recognising that:

> It would have been folly on the part of the legislature to attempt to define or limit what interests should be protected or how: to do so would have been to ignore the sad reality that the ingenuity of fraudsters [is] inexhaustible, their snares for the gullible pitiless and of infinite variety …[13]

Folly indeed. As is the poacher becoming gamekeeper in 1998 subsuming fiduciary law beneath well-intended but poorly implemented statute, as the judicial responses analysed in Chapter 4 illustrate. Warning bells were ignored.

Malfeasance and egregious behaviour is not restricted to MIS: it occurs in funds controlled by registered organisations. ASIC's good intentions have been subverted by those ignorant of fiduciary obligations. Workers Entitlement Funds are MIS, exempted on an annual basis from Part 5C of the *Corporations Act*.[14] These have been the subject of media disclosure and analysis by Heydon. There is a dearth of independent reliable empirical data which could be remedied by the Hayne Royal Commission with reform enforced by ASIC and the ROC.

3.13 The Wallis Legacy: Disclosure, Financial Advice and Financial Literacy

Implementation failures in these three Wallis principles are directly attributable for 25.84% of the incidences of systemic failure (Table 3.24). They are indirectly attributable to another 32.34%, being a total of 58.18% of systemic incidences (Table 3.24). This is failure of law on a massive scale. It

[12] *Australian Softwood Forests Pty Ltd v A-G (NSW)*; *Ex Rel Corporate Affairs Commission* [1981] HCA 49 [37] (Murphy J).
[13] *Australian Securities and Investments Commission v Bridgecorp Finance Ltd* [2006] NSWSC 836 [17] (Barrett J) citing *Australian Securities and Investments Commission v Mauer-Swiss Securities Ltd* [2002] NSWSC 684 (Palmer J).
[14] ASIC, *ASIC Class Order: Employee Redundancy Funds: relief*, CO 02/314 (2014); extended by ASIC Instrument: Corporations (Employee Relief) 2015/1150 (December 2015). ASIC has fashioned a new legislative instrument [CO 02/314] — ASIC Corporations (Employee Redundancy Funds Relief) Instrument 2015/1150 — to extend relief to 1 October 2018.

fails to recognise that investors are (forcibly) financial consumers,[15] not suppliers of capital. 'Products [that] have been designed to be attractive to sell rather than meeting the needs of consumers'.[16]

It explains community perceptions of ASIC and the frustrations with ASIC uncovered in the qualitative research but without their comprehension of ASIC being trapped in an ex post restrictive mandate. This empirical data cries out for reform of that mandate. The *Managed Investments Act* facilitated dramatic growth in the availability of collective investment opportunities but deficiencies in its implementation have contributed to large investor losses. Disclosure is not sufficient; financial advice has been conflicted and deficient, undisciplined by the necessary financial literacy of consumers unable to provide informed consent. Reliance on '[d]isclosure assumes that the capacities of financial consumers and retail investors are universal and rational, when research is showing that this is not the case'.[17] Chapter 4 analyses how egregious behaviour, quantified here, has been able to develop.

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[15] See, eg, Dimity Kingsford Smith, 'ASIC regulation for the investor as consumer' 29 *Companies and Securities Law Journal* 327, 328.
[16] Ben Butler, 'Can a change of guard fix ASIC's image?', *The Weekend Australian Business* (Sydney), 22–23 September 2018, 29 quoting Peter Kell, retiring ASIC Commissioner.
[17] Kingsford Smith, above n 15, 330.

CHAPTER 4: A TRAVERSE OF THE JUDICIAL RESPONSE 1981-2018

The Australian Enigma

Most Australian collective investment non-bank financial entities (NBFEs), superannuation and managed investment schemes (MIS), are trusts. Other jurisdictions also use trust structures for collective investment. In Germany, whilst described as trusts, they are structured as companies. Australia is a global outlier in the use of trusts as large commercially operating investment vehicles and in the manner of their deployment. This is an enigma. Directors must comprehend the various statutes that govern these vehicles as well as the applicable general law. There are many instances where directors assume trustee liability, often inadvertently. This chapter analyses the various overlays of director and trustee duty and explains the interwoven statutory and fiduciary conundrum. It describes the evolution of director and trustee duties, the evolution and meaning of the best interest duty, the failures of that duty by fiduciaries, and the use of trusts as surrogate companies. It analyses the case law arising from the circumstances leading to *Bitter Harvest* and the unhealthy culture unearthed and amplified in the Heydon Royal Commission.

1. INTRODUCTION

The cases and the empirical analysis demonstrate how directing minds manifest in undesirable corporate behaviour. Malfeasance has been common in Australian NBFEs. Between 2000 and 2010, there were 1972 court cases involving breaches by directors and officers of the *Corporations Act*.[1] Unhealthy culture can rarely be changed by statute: powerful statutory intervention can ameliorate, but not cure. Cultural change is generated by other social powers. These can be reflected in an uncompromised fiduciary duty of economic loyalty driving proper practices in the investment chain for the benefit of investors and other beneficiaries. 'The fiduciary obligation is a demanding standard of propriety in conduct that is unequalled elsewhere in the law',[2] requiring 'complete loyalty to the service of another's interests'.[3] Fiduciary duty supports desirable cultural change. It provides a framework for standards of behaviour, for enforcement and for restitution. It is the Damoclean Sword over the heads of malfeasors.

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[1] Lisa Barnes, 'The Albatross around the neck of company directors — A journey through case law, legislation, and corporate governance' (2013) 12(1) *The Journal of Law and Financial Management* 3.

[2] Andrew Tuch, 'Investment Banks as Fiduciaries: Implications for Conflicts of Interest' (2005) 29 *Melbourne University Law Review* 478, 479 citing *Bristol & West Building Society v Mothew* [1998] Ch 1 [16] (Millett LJ).

[3] Ibid 481, citing P D Finn, 'The Fiduciary Principle' in T G Youdan (ed), *Equity, Fiduciaries and Trusts* (Carswell, 1989) 1, 27.

Those that have profited from the absence of uncompromised loyalties are those that resist legislative interventions and are organised with a plethora of industry associations and paid lobbyists. Intermediaries in the investment chain often have conflicts of interest and profit from them. To prefer client interest over their own may mean loss of profit. It may mean declining business if there is a conflict of interest.

This chapter discusses the evolution of director duties and of trustee duties and the connections between them. It explains the Australian enigma - trusts as commercial enterprises and surrogate companies - and how present law focussed on contractual rights and statutory compliance fails to protect and nurture investor expectations. It analyses the many interpretations of best interest and offers the basis for reform and legal clarity. It describes the failures of fiduciaries to provide competent, unconflicted financial advice, the absence of effective disclosure, client and investor lack of financial literacy, and inability to provide informed consent. It illustrates how these failures generate an unhealthy culture which affects Australian financial advice and financial products markets to this day.

The cases refine the law applying to each of the Wallis principles financial advice, disclosure and financial literacy. However, these cases, many of them useful, are piecemeal, primarily tactical and always after the fact (ex post). Rarely do they strike at the heart of the fundamental reason for systemic failure, namely statutory subsuming and deficient enforcement of fiduciary principles of loyalty in the investment chain.

They do strike directly at a major reason for systemic failure, namely statutory complexity and uncertainty. Complexity and sheer volume of detail provide cover for creeping corruption (in UK terminology, creative compliance or regulatory arbitrage). Legal analyses of similar issues in like jurisdictions together with revelations from Australian case law provides a sound rationale for more stringency in policy sufficient to deter director and trustee malfeasance.

A first theme from 1981-2018 has seen an increase in the number and size of statutes, often provoking judicial frustration and negative comment.[4] Empirical analysis demonstrates that legislation (the 'Age of Statutes')[5] has not prevented manifestation of systemic problems or reduced their cyclical recurrence. Instead, it has created a large compliance industry with attendant direct and indirect costs. These costs are ultimately borne by beneficiaries and investors. They also manifest in market consolidation in attempts to capture economies of scale in an attempt to reduce unit costs to those

[4] See, eg, ch 1, fn 38.
[5] Mark Leeming, 'Equity: Ageless in the "Age of Statutes"' (2015) 9(2) *Journal of Equity* 108.

investors and beneficiaries. Regulatory intervention into the superannuation sector requiring consolidation is an example. Statutory evolution has been and remains politically contested reducing its effectiveness as lobby groups pursue their particular interests.

A second theme is the role of equitable principles including fiduciary duties. As Donald accurately points out, misuse of the adjective fiduciary by politicians and lobby groups has resulted in a mismatch of community expectations and the reality of fiduciary law in the Australian financial sector.[6] Principles based general law has often provided the basis for the resolution of many specific cases in this chapter and in the empirical analysis. 'Each of statute and equity influences the other [although] there is no judicial power to sunset some statutes as there is in the common law.[7] In the meantime,

> It is ironic, then that those same political processes that are privileging these nobler qualities [of fiduciaries] are in fact de-coupling the regulatory regimes from the general law antecedents in which those qualities were initially expressed. Political processes are ensuring that what the law expects of Mason J's quintessential fiduciaries, or at least those whose activities encroach on areas of public policy, are regulated by multi-layered, highly specific, bespoke regulatory regimes that largely eclipse the proscriptions and prescriptions of the general law.[8]

Accretive legislative change is not enough. Whilst 'we now live in an age of statutes and not of the common law,'[9] statutes have not eliminated systemic failures and their cyclical manifestations. '[C]omplying merely with the regulatory requirements may well leave the investment bank in breach of the fiduciary obligation'.[10] In other words, compliance with the statute may expose a director to breaches of the general or case law on fiduciary obligations.[11] Corruption rooted in cultural mores[12] requires a rethink of assumptions of robustness in statutory construction',[13] and the adoption of 'principles drawn from the law of trusts and from fiduciary law…'[14] The statutes seek to manage

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[6] M Scott Donald, 'Regulating for fiduciary qualities of conduct' (2013) 7(2) *Journal of Equity* 142 [1].
[7] Leeming, above n 5.
[8] Donald, 'Regulating for fiduciary qualities of conduct', above n 6, 142 [2].
[9] Paul Finn, 'Public Trusts, Public Fiduciaries' (2010) 38 FLR 350.
[10] Tuch, above n 2, 515.
[11] In financial advice, see, eg, Simone Degeling and Jessica Hudson, 'Fiduciary Obligations, financial advisers and FOFA' (2014) 32 *Companies and Securities Law Journal* 527; Simone Degeling and Jessica Hudson 'Equitable money remedies against financial advisers who give "advice about advice"' (2015) 33 *Companies and Securities Law Journal* 166.
[12] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report* (December 2015) (Commissioner Heydon) ['Heydon'].
[13] Finn, 'Public Trusts, Public Fiduciaries', above n 9, 336.
[14] Ibid 335.

whereas the solution is excision. Andrew Tuch concludes: 'These problems are at the core of the structure of the financial markets'.[15]

As Heydon points out, unhealthy culture can spread across regulatory jurisdictions, especially in a consolidating and vertically integrating NBFE sector, not restricted to or originating from registered organisations. It recurs in every segment of the NBFE sector. Excision means that 'all payments by employers to a relevant union or officials of that union be outlawed'.[16] For the NBFE sector in aggregate, this remedy should be extended to related party transactions, whether or not Chinese Walls are in place.

Cultural change to ensure Australians have 'reasonable expectations'[17] of the observance of fiduciary obligations and principles is a generational task. That economic loyalty, already enshrined in the general law but subsumed by statute, should require reinforcement is a sad reflection on the efficacy of the legislature. It is a public policy issue to enforce effective disclosure, require conflicts avoidance and balance information and vulnerability asymmetries between provider and client.[18]

International practice in like jurisdictions provides useful guidance. Presently in Australia, to the extent fiduciary principles are understood at all, respect for their principles is not widespread. Previously, in Canada, '[c]alls for holding such advisers to a fiduciary standard were simply ignored...'[19] Fiduciary principles are often ignored being subservient to adherence to specific statutory provisions which focus on process, legal rights and interests rather than value outcomes. So directors can be honest but in breach of the law, and conversely, 'act without bad faith yet not in good faith':[20] compliance with the letter of the law but not honouring its spirit or community expectation. Presently, there is a public policy question as to whether statutory regulation 'adequately protects those to whom the general law would grant protection, if enforced, afforded by the fiduciary relationship'.[21]

The politicisation of policy direction is clouded by antiquated ideas of the modern corporation and the modern trust. Much is made of the historic distinctions between a company (narrowly defined as shareholder owners) and trusts (narrowly defined as trustee-members). Superannuation entities are

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[15] Tuch, above n 2, 516.
[16] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 12, ch 4, rec 41, 60–67 (Commissioner Heydon).
[17] Tuch, above n 2, 483.
[18] Ibid 505.
[19] Saul Schwartz, 'The Canadian Task Force on Financial Literacy: Consulting without listening' [2011] 51 *Canadian Business Law Journal* 359.
[20] *Timothy Marcus Clark and FAI General Insurance Company Limited v The State of South Australia and State Bank of South Australia* [1994] SASC 5210 [2] (Bollen J).
[21] Tuch, above n 2, 514.

now large, growing complex financial businesses, often with direct and related party commercial activities, increasingly international in scope akin to large commercial trading trusts, becoming conglomerate-like. Likewise, the concept of a company is much developed from its antiquarian origins resulting in 'a more interventionist court.'[22]

Vested interest and resistance to change using spurious argument clouds reform. The lessons of other jurisdictions where there are governance models which do give effect to the interests of all stakeholders have been ignored or lost in Lilliputian conflicts.

[22] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No 3)* [2012] WASCA 157 [2027] (Drummond AJA) ['Bell'].The impacts of corporate decision making on a wider range of interests than shareholders are now being given more recognition … it serves to explain why modern company courts have become more interventionist, in reviewing the activities of directors than was traditionally the case: at [2051] (Drummond AJA).

2. THE EVOLUTION OF DIRECTOR AND TRUSTEE DUTIES

2.1 Directors, officers and trustees: multiple roles, duties and responsibilities

NBFE directors and trustees are drawn from the community. Many have limited understanding of their duties.[23] There is no profession of director in Australia nor formal training requirement. Directors of companies and trustees personally or as directors of a corporate trustee are fiduciaries. A fiduciary must act personally although modern law distinguishes between a director's duty and a trustee's duty. But trusts are commonly used as surrogate companies and superannuation entities in Australian NBFE markets requiring director comprehension of trust law, several statutes and their interaction. Statutory complexity and uncertain application of fiduciary principles not only provides for malfeasance opportunities. It also generates traps for well-meaning and honest directors and trustees reliant on external and internal advice. These traps are sometimes unknown, misunderstood, or wilfully ignored. Here is an explanation of them.

In a consolidating NBFE market, directors have multiple roles. These are becoming more widespread and in some cases conflict. '[A]ll of these are bound to the investor-beneficiaries by a web of fiduciary relationships both orthodox as well as unusual'.[24] Corporate form and structure are subservient to actions and context. Context includes 'undertakings, vulnerability to another's power or vulnerability necessitating reliance, and reasonable expectation.'[25] Corporate law and theory now robustly recognise stakeholders, being an onion ring of interests and interest groups circling the traditional preoccupation of the board—the shareholders. The need to ensure protection of those interests: '[e]xplains why modern company courts have become more interventionist. [They are prepared to review] the activities of directors [more] than was traditionally the case'.[26] In Australia the legal impacts of corporate decision-making are now recognised in a wider range of interests than shareholders, but the '[e]xpansion of the range of interests to which corporate management must have regard in its decision-making has not gone as far in Australia as it has in the UK'.[27] Or in other jurisdictions.

Directors sometimes act with self-interest with blatant breaches of their fiduciary duties.

[23] See above ch 1, s 14.
[24] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windsor* [1995] FCA 1663 [58] (Finn J).
[25] Ibid [72] (Finn J).
[26] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No 3)* [2012] WASCA 157 [2051] (Drummond AJA).
[27] Ibid [2050] (Drummond AJA).

> A dealing by a trustee or by a company director, in breach of the fiduciary obligation not to act where there is a conflict between the fiduciary duty and another duty or self-interest, is a common breach of fiduciary duty. The subject of the prohibited dealing may be trust property or company property.[28]

For instance, a director's participation or voting in a board meeting where there is a material personal interest is a breach of the director's fiduciary duty, and the *Corporations Act*.[29] It is difficult to determine a 'precise formula that will determine the extent of detail that is called for when a director declares his interest or the nature of his interest'.[30] Disclosure declarations must make colleagues 'fully informed of the real state of things'.[31] 'If it is material to their judgment that they should know not merely he has an interest, but what it is and how far it goes, then he must see to it that they are informed'.[32]

The role and duties of trustees in trusts are well settled in law. A trust can only operate through a trustee, corporate or personal with the trustee holding the trust property for the beneficiaries. Trustees have 'an irreducible core of obligations'.[33] These beneficiaries can be unitholders in a unit trust or investors in a managed investment scheme. Trusts are governed by *State Trustee Acts* (in Australia) but the *Corporations Act* also regulates MIS, which are a specific type of trust. The directors of the responsible entity (RE) are directors of a corporate trustee as well as directors of a company. Directors of the corporate trustee have fiduciary obligations to the company, but best interests obligations to the members of the MIS. The trust deed and constitution creating and operating the MIS define responsibilities, but not to the exclusion of general law or the *Corporations Act*. Potentially dangerous contradictions arise for those directors in some MIS exacerbated where there are multiple MIS and where superannuation entities are included in the corporate group, sometimes investing in related party MIS.

Superannuation schemes are usually trusts established by trust deed with a corporate trustee. The trust deed is a document that imposes specific trustee obligations on the trustees. Typically:

> the deed or other instrument establishing the scheme is a trust deed or imposes trustee obligations on the persons in charge of the scheme … The trustee must not only comply with the provisions of the

[28] Justice David J S Jackson, 'The First Limb of Barnes v Addy: A taxonomy in tatters' (Speech delivered at the W A Lee Equity Lecture, Banco Court, QE11 Courts of Law, 27 November 2014) 29.
[29] *Corporations Act 2001* (Cth) s 195(1).
[30] *ASIC v Australian Property Custodian Holdings Ltd (No 3)* [2013] FCA 1342 [225] (Murphy J).
[31] *Gray v New Augarita Porcupine Mines Ltd* [1952] 3 DLR 1.
[32] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 [938] (Rares), quoting *Imperial Mercantile Credit Association v Coleman* (1873) LR 6 HL 205.
[33] *Rankine v Rankine* [1998] QSC 48 (de Jersey J).

> relevant trust deed or other instrument, but is subject to common law principles of trust law. The centre-piece of trust law is the fiduciary obligation. …[34]

So the trustee may have a fiduciary relationship with the beneficiary. Where this exists, director's responsibilities are not only to the trustee company but also to the beneficiary.[35] It reflects the modern statutory duty of the superannuation trustee.[36] This statutory intervention resulting in a direct fiduciary nexus between the director of the corporate trustee and the beneficiary of the trust is a recent evolution of the law and 'operates as if the directors were party to the governing rules'.[37] The statute departs from the general law of trusts and imposes a positive duty to '"promote" the financial interests'[38] of the beneficiary (being different from their best interest). This may require the trustee to invest trust funds in a superannuation product administered by another trustee.[39] Previously, for non-superannuation entities, this nexus only arose in 'special circumstances creating a direct fiduciary relationship between a director and a beneficiary'.[40] It arises from director's conduct in exercising their powers causing their company to commit a breach of trust. It opens directors of trustee companies to accessorial general law liability if that person has not 'at the least' obtained 'informed consent'[41] and if that person has 'knowingly or recklessly assisted in or procured a breach of trust or of a fiduciary duty by the trustee.'[42] For directors of corporate trustees (usually companies) of superannuation entities, 'the direct liability of the directors of corporate trustees of superannuation entities is not limited to that which can arise under their common law duties'.[43]

The trustee must adhere to and 'rigidly'[44] carry out the terms of the trust deed which overrides all other duties. In MIS or other trusts where the beneficiaries are investors, adequate disclosure of risk

[34] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [318] (S A Forgie V-P and B H Pascoe); citing *Bartlett v Barclays Bank Co Ltd* [1980] Ch 515–534 (Brightman J).
[35] *Superannuation Industry (Supervision) Act 1993* (Cth) ss 52(A), 52(A)(6), 29VN(b).
[36] Ibid s 52(2).
[37] *Superannuation Industry (Supervision) Act 1993* (Cth) s 52A(2)(6). See especially Pamela F Hanrahan, 'Directors' liability in superannuation trustee companies' (2008) 2 *Journal of Equity* 3 [111B]; *Superannuation Industry (Supervision) Act 1993* (Cth) s 52A(2) covenants quoted in Donald, 'Regulating for fiduciary qualities of conduct', above n 6, 142 [1].
[38] *Superannuation Industry (Supervision) Act 1993* (Cth) s 29VN.
[39] Donald, 'Regulating for fiduciary qualities of conduct', above n 6, 142 [1].
[40] Hanrahan, 'Directors' liability in superannuation trustee companies', above n 37, 204.
[41] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windsor* [1995] FCA 1663 [81] (Finn J).
[42] Ibid [82] (Finn J).
[43] Hanrahan, 'Directors' liability in superannuation trustee companies', above n 37, [111].
[44] *Pikos Holdings (Northern Territory) Pty Ltd v Territory Homes Pty Ltd* [1997] NTSC 30 (Kearney J).

involved in the investment must be made.[45] The trustee must implement the terms of the trust deed, exercised personally. Delegation authorities, are provided for in statute[46] and general law, subject to the terms of the trust deed, which must be specific. The trustee, including REs, are liable for the delegatees' acts and omissions, even if they are ultra vires.[47] A trustee or director cannot fetter their exercise of power and cannot act on the instructions of another person.[48]

A trustee is bound to invest trust funds in order to earn income for the beneficiaries and it is not safely preserved if not invested.[49] Trust deeds can contain specific instructions in respect of investment powers. Trustees must act in accordance with the deed even if the deed authorises investments which otherwise may not be allowable. Otherwise, in the absence of directions, investment powers are governed by the *State Trustee Acts*.[50] A trustee can be in breach of duty by failing to act when it should have done so. There is a positive obligation to protect or promote trust assets, and it is not acceptable for a trustee to be passive in its management of the trust.

General law and statutory interventions impose further duties. Statutory interventions include the *Corporations Act.*[51] These sections specify that an RE holds scheme property in trust for scheme members and that the RE directors duties to the company are overridden by their duties to the scheme members. Limitations on directors' (of the RE) indemnity out of (registered) MIS property may result in a 'much more extensive direct liability under Ch 5C of the *Corporations Act* than for a director of a superannuation trust company under the [*Superannuation Industry (Supervision)*] *SIS Act*'.[52] The *SIS Act*[53] codifies trustee and director fiduciary duties to beneficiaries using familiar language of the general law. The *Fair Work (Registered Organisations) Act* did not include such provisions and does not provide statutory enforcement of fiduciary principles, although 2016 reform aligns the directors' and officers' duties of registered organisations with those of companies.[54] Further nuances in director

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[45] McMahon Clarke, , 'Guidelines for Trustees and Responsible Entities: Duties Liabilities and Safeguards' (Monograph, 14 August 2014) <http://www.mcmahonclarke.com/cmsAdmin/uploads/trustee_guideline.pdf> 8.
[46] See, eg, *Superannuation Industry (Supervision) Act 1993* s 52(A)(4).
[47] *Corporations Act 2001* (Cth) s 601FB.
[48] *Superannuation Industry (Supervision) Act 1993* ss 52(2)(h), 58. This latter section was originally introduced as the *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013* (Cth). Directors of non-superannuation corporate trustees are subject to the general law having a fiduciary duty not to fetter discretion, and the governing documents of the company. See, eg, *Davidson v Smith* (1989) 15 ACLR 732 at 734 (Ipp J).
[49] *Adamson v Reid* (1880) 6 VLR (Eq) 164; *Byrnes v Kendle* [2011] HCA 26.
[50] McMahon Clarke, above n 45, 25.
[51] *Corporations Act 2001* (Cth) ss 601FC(2), 601FC(3).
[52] Hanrahan, 'Directors' liability in superannuation trustee companies', above n 37, [111B].
[53] *Superannuation Industry (Supervision) Act 1993* (Cth) ss 52 (2), 52(8), 29VN.
[54] *Fair Work (Registered Organisations) Amendment Act 2016* (Cth) Explanatory Memorandum.

direct liability including interpretations of deceptive and misleading conduct arise from the differing definitions of financial products and financial services in the *Corporations Act*[55] and the *ASIC Act.*[56]

Previously, under the general law directors were acknowledged to have accepted a trust and therefore accurately to be described as trustees:[57]

> the duties of a director are derived from, although not identical with, the duties of a trustee to the cestui que trust and the duties of an agent to the principal to the extent to which those duties arose out of the fiduciary aspect of the relationship of principal and agent … when, in relation to those duties, reference was made, not to 'negligence' in the common law sense, but to imprudence of such a nature as to constitute a breach of trust … and] references to a directors duties at law were to be regarded as references under the general – non-statutory – law as opposed to those imposed on directors by statute.[58]

The general law continued the evolution of the distinction between the responsibilities of trustees and directors, 'impossible to describe the duties of directors in general terms, whether by way of analogy or otherwise.'[59]

Modern law attempts to differentiate between trustee duty and directors' duty arising as a result of their differing functions. The directors' role requires an exhibition of entrepreneurship. Directors are entitled to take reasonable risks. The trustee role requires restraint. 'While the duty of a trustee is to exercise a degree of restraint and conservatism in investment judgments, the duty of a director [of a company which is not a trustee] may be to display entrepreneurial flair and accept commercial risks to produce a sufficient return on capital invested'.[60]

> Underlying the distinction today is, probably, not merely an historical assumption about the separate purposes of companies and trusts, but also a generalisation about the different risks that persons who invest their assets in companies on the one hand and trusts on the other are considered likely to have assumed … [w]here the trustee is itself a company the requirements of care and caution are in no way

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[55] *Corporations Act 2001* (Cth) s 764A(1)(g).
[56] *Australian Securities and Investments Commission Act 2001* (Cth) s 12BAA(7)(f).
[57] Masonic and General Life Insurance Co v Sharpe [1892] 1 Ch 154; *Re Newcastle-upon-Tyne Marine Insurance Co, Re Ex parte Brown* (1854) 19 Beav 97.
[58] *Railway and General Lights Improvement Co, Re (Marzetti's case)* (1880) 28 WR 54.
[59] *City Equitable Fire Insurance Co Ltd, Re* [1925] Ch 407 [1924] All ER 485.
[60] *Daniels v Anderson* (1995) NSWCA (Clarke JA, Sheller JA, and Powell JA) 13 ACLC 614; NSWLR 438.

diminished. And here, unlike companies in general, these requirements have a flow on effect into the duties and liabilities of the directors of such a company.[61]

2.2 Standards of care

Duties of care and diligence are not statutorily restricted to s 180(1) of the *Corporations Act*. The *Corporations Act* has two provisions relating to standards of care required of directors of an RE.[62] For directors of MIS, s 601FD(i)(b) extends s 180(1). An RE is a corporate trustee and 'the standard of care for an officer under s 601FD(1)(b) is higher than the corresponding duty under s 180(1) … scheme members [being] particularly vulnerable to potential conflicts of interest'.[63] So directors of REs owe their duty of care to scheme members in addition to their company, in contrast to other directors. There is no business judgment defence under s 601FD. Similarly, directors of superannuation entity corporate trustees owe their duty to fund beneficiaries as well as to the corporate trustee, being the introduction of a statutory prescriptive fiduciary duty.[64]

Standards of care expected of trustee companies and their directors, their fiduciary obligations, and accessorial liability have evolved. Directors can assume trustee liability,[65] but not always so — it depends on context: 'the duties of trusteeship of the company can give form and direction to the common law and statutory duties of care imposed on directors, where the directors themselves have caused their company's breach of trust.'[66] The trustee must meet a higher standard than the ordinary prudent person test. Directors can be more risk seeking than a trustee, whose duty includes not just the generation of trust income but also the preservation of trust capital.

That the director of a corporate trustee be a director of a related entity can concurrently be the same person managing the same underlying assets is one of many conundrums leading to uncertainty in

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[61] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windsor* [1995] FCA 1663 [47] (Finn J).
[62] *Corporations Act 2001* (Cth) ss 180(1), 601FD(1)(b).
[63] *Trilogy Funds Management Limited v Sullivan (No 2)* [2015] FCA 1452 [211] (Wigney J) quoting Murphy J: (a) … the relevant director will be the director of the RE acting as trustee (and usually holding itself out and being paid as a professional trustee; and (b) the scheme members will be vulnerable to: (i) conflicts of interest between the RE's interest in obtaining fees and the interests of the members, and/or (ii) conflicts between the RE's interest in obtaining fees and its duty to act in the members' best interest and give their interests priority, *ASIC v Australian Property Custodian Holdings Ltd (Receivers and Managers appointed) (in liquidation) (Controllers appointed) (No 3)* [2013] FCA 1342 [526], [543].
[64] *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(8).
[65] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windsor* [1995] FCA 1663 [77]–[79], [82], [287] (Finn J). Finn did not wish 'to reignite the arid debate on whether directors are trustees': at 48.
[66] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windsor* [1995] FCA 1663 [48] (Finn J).

NBFE governance. This applies to defining appropriate standards in due diligence investigations where there is not necessarily an objective test. What constitutes acceptable due diligence can be subjective, with the only arbiter being the court. Whilst trustees may engage third party professional advisers in due diligence investigations, their advice is meaningless in a subjective environment.

There are also different standards required depending on the type of trustee. Nowadays, directors of professional trust companies, including REs are expected to demonstrate a greater level of expertise and standards of care than non-professional trustees. '[A] professional corporate trustee is liable for a breach of trust if loss is caused to the trust fund because it neglects to exercise the special care and skill which it professes to have'.[67] This evolution of a higher standard emulates US and Canadian law.[68] The former standard of care evolved a century ago when trust corporations were not used for commerce:

> during a period when trust corporations were not used for the trading and investment purposes that are now commonplace [in Australia] today. There is, in my view, a substantial question now to be answered as to whether a higher standard is not to be exacted for at least professional and corporate trustees which hold themselves out as having a special or particular knowledge, skill and experience. …[69] I consider that the standard of care applicable where a corporation is a professional trustee, holding itself out to the public and being paid as such, will often be a more exacting standard…[70]

The responsibilities of these entities are not diminished by the comparative responsibilities of other types of trustee,[71] which do not 'conduct trust businesses or render professional trust services'[72] for a fee.

2.3 Prioritisation versus prohibition

Trustee standards are based on prohibition, not prioritisation, as is presently the case under the *Corporations Act*. This is one reason why the application of fiduciary duties and trustee standards across the NBFE sector becomes so important. Under trust law, the no-conflict and no-profit rules prohibit: (i) the entering into any agreement in which personal interest or the possibility of personal interest conflicts with the duty to the trust; and (ii) the obtaining of personal profit or advantage by

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[67] *Bartlett v Barclays Bank Trust Co Ltd (No 1)* [1980] 1 Ch 515 [534] (Brightman J).
[68] *Fales v Canada Permanent Trust Co* (1977) 2 SCR 302 (Canada).
[69] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windsor* [1995] FCA 1663 [50] (Finn J).
[70] *ASIC v Australian Property Custodian Holdings Ltd (No 3)* [2013] FCA 1,342 (Murphy J) ['Prime Trust'].
[71] *Fouche v The Superannuation Fund Board* [1952] HCA 1 (Dixon CJ, McTiernan and Fullagar JJ).
[72] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windsor* [1995] FCA 1663 [54] (Finn J).

virtue of being a trustee.[73] It matters not that the trustee acted honestly and in the beneficiaries best interest, or that the profit would not have been made but for ‘the skill and judgment of the trustee.’[74] It follows therefore, that trust deeds are extremely important documents in the NBFE investment sector and they determine whether or not a related party can contract in a capacity other than in its capacity as trustee of a trust.

2.4 Related party transactions and conflicts of interest

Related parties and conflicts of interest are common in MIS. The empirical analysis suggests that related party transactions have predictive veracity to conflicts of interest, failures in disclosure, dishonesty and breaches of statutory and fiduciary duties. These can lead directly to unjust enrichment. *Jones v Invion*[75] demonstrated how director’s breaches of their statutory and fiduciary duties[76] entitled their ASX listed company to statutory[77] and equitable compensation.

The directors acting ‘in concert’[78] did not confine themselves to improper board procedures, but were also aware of shareholder disquiet about corporate governance and their likely rejection of approval for remuneration in the form of performance rights. For these directors, a corporate governance standard which relied upon unminuted oral agreement several years previously whereby ‘any of them, acting alone, could exercise the authority of the Board’[79] was sufficient. There could be ‘no suggestion that the non-executive directors were fully informed’.[80] In fact, they were incorrectly informed.

Recusal from a meeting is common practice in Australia where there are related parties and conflicts of interest. *Jones v Invion* makes a mockery of such practices. Recusal and mere disclosure are not

[73] McMahon Clarke, above n 45, 28.
[74] Ibid.
[75] *Jones v Invion Ltd* [2015] QCA 100 (McMurdo P and Philippides JA and Peter Lyons J): ‘The directors acted dishonestly, and breach of their duties, when, without authority, each of them purported on behalf of the first respondent, to vary the termination provisions of the contracts or consultancy agreement of another of them … [and] did not tell the full board of the changes. … This “unjust enrichment” was [stated to be]: the “conventional” way of transacting such business within the company … the directors by-passed the Board because they surmised the Board would not agree. Consistently, they did not disclose to the Board what they had done. … The [appellant] directors were patently obliged to inform their fellow [non-executive] directors of those matters, especially where the solvency of the [first respondent] was in doubt, the contingent liability was so substantial, and the [appellants] were themselves the potential beneficiaries’.
[76] *Corporations Act 2001*(Cth) ss 180, 181, 182.
[77] Ibid s 1317H.
[78] *Jones v Invion Ltd* [2015] QCA 100 [14] (McMurdo P and Philippides JA and Peter Lyons J).
[79] Ibid.
[80] Ibid.

sufficient.[81] '[C]ould hardly be considered arms-length … It rather suggests the contrary, that it was a collegial or corporate or complicit endeavour'.[82]

Dishonest behaviour may in some circumstances have an honest explanation. Relief from liability requires a positive finding of honesty, not available to these Invion directors. These directors 'owed fiduciary duties to the company of which they were directors, to avoid conflict of duty and interest and not to take advantage of their position to secure a personal benefit.[83] They did not exercise reasonable care and diligence,[84] or act in good faith,[85] and used their 'position to gain personal advantage'.[86]

In *Trilogy v Sullivan:*[87]

> This is a tale of a rapacious Gold Coast property developer with grandiose plans, a compliant and obliging valuer who lacked independence, and a responsible entity of a managed investment scheme the officers of which appeared unable or unwilling to say 'no' to the developer, or to exercise appropriate care and diligence… [T]he scheme and its members were left significantly out of pocket.[88]

Some directors 'well knew that the proposal was not supported by any remotely acceptable "as is" valuation…'[89]

Another Gold Coast related party case, *Managed Investments*:[90]

> The insouciant attitude of the defendants to this misuse of money intended to be used for the PIF's investors beggars belief.[91] [T]hose controlling responsible entities … must act with honesty and competence and remember at all times that they are dealing with other people's money.[92]

In a consolidating NBFE market with a limited supply of knowledgeable directors, trustees, and professional advisers, it is inevitable that their fiduciary duties be compromised by conflicts of

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[81] *Fitzsimmons v The Queen* (199) 23 ACSR 355 cited in Rosemary Langford, *The Bona Fide Fiduciary Loyalty of Australian Company Directors* (PhD Thesis, Faculty of Law Monash University, 2013) 314 [3.7.4].
[82] *Jones v Invion Ltd* [2015] QCA 100 [57] (McMurdo P and Philippides JA and Peter Lyons J).
[83] Ibid.
[84] *Corporations Act 2001*(Cth) s 180.
[85] Ibid s 181.
[86] Ibid s 182.
[87] *Trilogy Funds Management Limited v Sullivan (No 2)* [2015] FCA 1452 (Wigney J).
[88] Ibid [1] (Wigney J).
[89] Ibid [612] (Wigney J).
[90] *ASIC v Managed Investments Ltd (No 10)* [2017] QSC 96 (Douglas J).
[91] Ibid [233] (Douglas J) describing the conduct of directors of the RE of the Premium Income Fund.
[92] Ibid [232d] (Douglas J).

interest, actual or potential.[93] Commercial practice has been to establish Chinese Walls. If they serve a useful or proper purpose, their scope is necessarily limited by the permeable nature of walls, originally designed to quarantine information from persons within one organisation. Where the proper exercise of fiduciary duty extends to decisions about fellow directors and trustees, including litigation, Chinese Walls are unlikely to suffice.[94]

In Australia, many public offer superannuation entities (industry funds) have representative directors from employers and employees. Originally with equal representation,[95] now subject to contested legislative change, these appointments do lead to conflicts of interest. There are no differences in the *SIS Act* in relation to responsibilities as directors of the trustee notwithstanding differences in the manner of the appointments.[96] This conflict appears to be an integral part of the SIS legislation.

> The potential for conflict by virtue of their appointment alone does not mean that there is a conflict of the sort that means a director is in breach of a fiduciary duty. There must be something more that shows that there is in fact a conflict of duty between the interests of the directors of a trustee of a fund. This must be determined by reference to the circumstances and not by references to a formula or recitation of principle.[97]

Conflicts of interest may be ameliorated,[98] but only in circumstances specifically to the appointment as representative director.[99] Naively, '[a] further safeguard to the protection of member's interests is to rely on a well-informed membership with the right to participate in managing the affairs of their fund'.[100]

2.5 Inconsistency and uncertainty in fiduciary law for Australian directors

The quality of decision making of directors, officers and their entities in the investment chain is fundamental to the success of Australian NBFE regulation. Directors and officers are status based

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[93] Nuncio D'Angelo, 'Private equity investing by financial institutions: Navigating hidden reefs in treacherous waters' (2003) 31 *Australian Business Law Review* 325.
[94] *Australian Executor Trustees Ltd v Provident Capital Ltd, in the matter of Provident Capital Ltd (receivers and managers appointed) (in liq)* [2013] FCA 1461 (Rares J).
[95] *Superannuation Industry (Supervision) Act 1993* (Cth) s 89.
[96] *Superannuation Industry (Supervision) Act 1993* (Cth) s 10(1).
[97] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [547] (S A Forgie V-P and B H Pascoe).
[98] *Sargeant v National Westminster Bank Plc* (1990) 61 P & CR 518 cited in *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [535] (S A Forgie V-P and B H Pascoe).
[99] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [535] (S A Forgie V-P and B H Pascoe).
[100] Commonwealth, Hansard, Superannuation Industry (Supervision) Bill, House of Representatives, 27 May 1993, 1101 [1] (Paul Keating, Treasurer).

fiduciaries, but their fiduciary responsibilities are confused and uncertain under present Australian law. A fiduciary duty is 'properly confined to those duties which are particular to fiduciaries',[101] breaches of which result in restorative equitable remedy. 'The distinguishing feature of a fiduciary is the obligation of [single minded] loyalty',[102] resting on trust and confidence between fiduciary and another, in this case investors and beneficiaries of NBFEs which they direct. It is this context that isolates fiduciary duty from other duties of fiduciaries including the duty of care.

Fiduciaries concurrently exercise fiduciary and non-fiduciary duties. Contractual and other non-fiduciary duties may co-exist with fiduciary duties. They are always exercised to the benefit of the beneficiary.[103] So, the sum of the duties exercised by a fiduciary are not the same as fiduciary duties. Whilst financial advisers have general law fiduciary duty to act in their clients' interest, this is not the same as their best interest.[104] Nor is it the same as the statutory overriding formulation relying on process rather than outcome.[105]

Acting in a positive way in satisfaction of the best interests duty is contested as non-fiduciary in character (unlike the US and Canada),[106] despite the obligation of fiduciary loyalty which 'underlies and unifies other fiduciary duties'.[107] As Finn opines:

> The scope, even the independent existence of, this duty are matters of contest in private law … [with] no uniformly agreed and accepted understanding of what the description 'fiduciary powers' signifies in private law.[108]

Recent judicial opinion suggests otherwise:[109]

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[101] *Bristol and West Building Society v Mothew* [1998] Ch 1 16 (Millet J) cited in Rosemary Teele Langford 'The duty of directors to act bona fide in the interests of the company: a positive fiduciary duty? Australia and the UK compared' (2011) 11(1) *Journal of Corporate Legal Studies* 215, 233.
[102] Ibid.
[103] M Scott Donald, '"Best" interests?' (2008) 2 *Journal of Equity* 253.
[104] Stephen Corones and Thomas Galloway, 'The effectiveness of the best interests duty — enhancing consumer protection?' (2013) 41 *Australian Business Law Review* 5, 16.
[105] See below ch 4, s 3.4.
[106] Donald, '"Best" interests?', above n 103, 251; see also Corones and Galloway, above n 104, 11.
[107] Langford, *The Bona Fide Fiduciary Loyalty of Australian Company Directors*, above n 81, 314 [1.1].
[108] Finn, 'Public Trusts, Public Fiduciaries', above n 9, 342–3 citing Geraint Thomas, 'The Duty of Trustees to Act in the "Best Interest" of their Beneficiaries' (2008) 2 *Journal of Equity* 177. See also John Lehane, 'Delegation of Trustees' Powers and Current Developments in Investment Funds Management' (1995) 7 *Bond Law Review* 36.
[109] *Babcock & Brown DIF 111 Global Co-Investment Fund, LP v Babcock & Brown International Pty Limited (No 2)* [2017] VSC 556 [40] (Hargrave J); *Westpac Banking Corporation v The Bell Group Ltd (in liq) [No3]* [2012] WASCA 157 [914], [1214] (Lee AJA, Drummond AJA, Carr AJA).

> Positive, prescriptive duties may arise as a consequence of their being 'no decision of which I am aware binding on this court to hold that the fiduciary duties of directors to their companies are so limited'[110] [to proscriptive duties]. It is a matter of opinion as to what the law is.[111]

Confusion reigns in the articulation of these principles in the terminology used by the legislature and subsequently in the media where fiduciary duty and best interest duty continue to be used interchangeably without distinguishing between proscriptive and prescriptive duties. This arises from recent context specific judicial interventions which should have limited holistic application to fiduciary duty in other broader contexts. It results in Australia becoming a legal outlier in fiduciary law setting its jurisprudence apart from most comparative jurisdictions by significantly narrowing the definition and operation of fiduciary duty, relying on statutes which, as Chapter 3 demonstrates, have manifestly failed those that they purportedly serve.

This recent Australian jurisprudence seeks to restrict fiduciary duties to proscription, being neither in a position of conflict of interest nor profit from their fiduciary position. '[J]udicial thinking about the content of fiduciary duties has changed significantly over the last decade … [being to] confine the fiduciary component of the overall relationship to a number of specific duties'.[112] Proscription requires restraint whereas prescription requires action (for obligatory duties) and positive actions for discretionary duties.[113]

But the proscriptive nature of general law fiduciary duty is not a unanimous view:[114] 'the law of this country does not otherwise impose positive legal duties on the fiduciary to act in the interests of the person to whom the duty is owed',[115] with Kirby J dissenting.

> A clear distinction between proscriptive and prescriptive duties may exist in some cases, but many situations could potentially be classified as involving duties of either kind … most but not necessarily all, fiduciary duties are proscriptive. However, it is dangerous to treat it as a talisman: it does not identify the reason for the existence (and hence the nature) of fiduciary duties.[116]

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[110] *Westpac Banking Corporation v The Bell Group Ltd (in liq)(No3)* [2012] WASCA 157 [1961] (Drummond AJA).
[111] Ibid [1976]–[1978] (Drummond AJA).
[112] *Aequitas v AEFC* [2001] NSWSC 14 [283] (Austin J).
[113] Langford 'The duty of directors to act bona fide in the interests of the company', above n 101, 219.
[114] *Pilmer v Duke Group Ltd (in liq)* [2001] HCA 31 (Mc Hugh, Gummow, Hayne, Callinan, Kirby JJ).
[115] *Breen v Williams* (1996) 186 CLR 71 cited in Langford 'The duty of directors to act bona fide in the interests of the company', above n 101, 228.
[116] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [1957] (Drummond AJA). See also Matthew D J Conaglen, 'Fiduciary Liability and Contribution to Loss' (2001) 60 *Cambridge Law Journal* 482.

These reasons include the requirement to act (or not to omit to act) in the best interest (or interest) of the company (however interpreted)[117] and to exercise duties of care. Often these duties require positive actions, sometimes discretionary, both in commission and prevention of omission which may not be fiduciary of themselves.

> It cannot be said that equity does not lay down prescriptive rules … [:] the prescriptive duty to act in the best interests of the company is imposed on directors because of equity, not some aspect of 'company law' which is outside of equity.[118]

The process of discharging of the fiduciary duties, whether proscriptive or prescriptive, is distinct from the nature of the fiduciary duty of itself.[119] Positive duties to provide information and obtain informed consent is fiduciary[120] also originate in contract and statute. Some opine that fiduciary duties do not extend to disclosure of information for informed consent purposes or the transfer of a profit making opportunity to the client. These are non-fiduciary duties governed elsewhere in the law and in accordance with specific facts.[121] Others, 'disclosure is now often said to operate as part of a defence to breach of duty'.[122] 'However even Finn accepts that duties of disclosure can properly exist in fiduciary law where fiduciary loyalty is an issue'.[123] Disclosure is practically manifested in investor offer documents: the fiduciary status of the offeror assumes some importance affecting their content.[124]

A promoter of an investment is a fiduciary.[125] Positive duties to honestly inform attach to those who 'owe fiduciary obligations because they are "promoters"'.[126] Promoter is not a defined legal term: the same persons can also be the RE, investment manager, or other NBFE. A fiduciary relationship can originate in such contracts: accordingly, 'whether a party is subject to fiduciary relationships is determined by construing the contract as a whole in the light of the surrounding circumstances known

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[117] See below, ch 6, tab 6.2.
[118] J D Heydon, 'Are the Duties of Company Directors to Exercise Care and Skill Fiduciary?' in S Degeling and J Edelman, *Equity in Commercial Law* (Lawbook, 2005) 187–237 cited in Langford, *The Bona Fide Fiduciary Loyalty of Australian Company Directors*, above n 81, 313 [6.3.1.2(e)].
[119] *Aequitas v AEFC* [2001] NSWSC 14 [309] (Austin J).
[120] Langford, 'The duty of directors to act bona fide in the interests of the company', above n 101, 227.
[121] Matthew Harding, 'Two fiduciary fallacies' (2007) 2 *Journal of Equity* 3.
[122] Langford, *The Bona Fide Fiduciary Loyalty of Australian Company Directors*, above n 81, 313 [5.2.1]–[5.2.3].
[123] Conaglen, above n 110, 482.
[124] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [1957] (Drummond AJA).
[125] *Babcock & Brown DIF 111 Global Co-Investment Fund, LP v Babcock & Brown International Pty Limited (No 2)* [2017] VSC 556 [35] (Hargrave J).
[126] Ibid (Hargrave J).

to the parties and the purpose and object of the transaction'.[127] It depends on the facts and the scheme documents in individual cases.

> [W]hether a fiduciary relationship exists in a particular case, and if so, the scope of that fiduciary relationship, are matters which depend critically on the particular circumstances of the case.[128] … The characteristics which define a fiduciary relationship cannot be exhaustively defined.[129] … Whether a fiduciary relationship has come into existence does not depend upon the motivation or desire of one party to establish a relationship of trust or confidence. What matters is whether there is a relationship involving the requisite undertaking, determined as a matter of objective characterisation, rather than having regard to the subjective expectations of the parties.[130]

Australian courts have previously resisted extension of fiduciary obligations 'to be used for creating new forms of civil wrong [being an] 'unsatisfactory development of the law of fiduciary obligation'.[131] 'It is questionable in my view whether this heralded development in our law is a desirable or necessary one [in the trust company context]'[132] However, elimination of systemic deficiencies in Australia's financial advice sector will require such extensions of fiduciary obligation. Judicial opinion where fiduciary obligation has been limited to strict proscriptions is contextually narrow and should not limit non-contextual cases to those narrow confines. There are precedents in Australian case law based on contract,[133] vulnerability and reliance,[134] reasonable expectation,[135] and in the extension of trustee director statutory fiduciary liability to Australian superannuation entity members personally.[136]

This uncertainty in the law has many ramifications for NBFEs, their directors, officers, and third parties associated with them,[137] investors and beneficiaries. The preferred view (which is the position in comparative jurisdictions) is that the contextual judicial determinations 'do not apply to the [non-

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[127] *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* [2007] FCA 963, FCR 35, 77 [281] (Jacobson J).
[128] *ABN Amro Bank NV v Bathurst Regional Council* [2014] FCAFC 65 [1066] (Jacobsen, Gilmour, and Gordon JJ).
[129] Ibid.
[130] Ibid.
[131] *Westpac Banking Corporation v The Bell Group Ltd (in liq) [No 3]* [2012] WASCA 157 [901] (Lee J, Drummond AJA).
[132] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windso*r [1995] FCA 1663 [78] (Finn J).
[133] *Hospital Products Ltd v US Surgical Corp* [1984] 156 CLR [72] (Gibbs J).
[134] Ibid [142] (Dawson J).
[135] *Mabo v State of Queensland (no 2)* [1992] 175 CLR 1 [200]–[201] (Toohey J).
[136] *Superannuation Industry (Supervision) Act 1993* (Cth) ss 52A(d), 55A(4A), 52(8), 29VN (a), (b).
[137] See below ch 4 s 3.

contextual] status-based fiduciary relationships such as that between director and company'.[138] This is a fundamental point of law striking directly at the mismatch between community expectations and market practice of those in the investment chain: Chapter 6 illustrates its importance.[139] 'It is a duty of fundamental importance',[140] being an essential part of undivided loyalty.

Scholarly research concludes:

> The existing state of Australian law in its approach to fiduciary duties lacks clarity and cohesion, particularly as concerns directors. Implementation of the proposals in this thesis would bring certainty and consistency … it paves the way for the rethinking of modern fiduciary theory'.[141]

This, and Langford's other proposals for 'extensive international analysis … [and for] corporate governance … organised and categorised around fiduciary duties'[142] are entirely consistent with the analysis of this author.[143]

Indeed, if both authors are correct in their analysis, HCA determination supported by reformed *Corporations Act* (following the *SIS Act*) to resolve the confusion and set Australia on the harmonisation path with international fiduciary standards is required. It would reinforce the power of fiduciary law to the benefit of investors and beneficiaries so manifestly poorly served, as Chapter 3 demonstrates, by existing statutes. Fiduciary law should not be 'mere polyfilla' to support inconsistent and incomplete statutes: 'clear recognition of the fiduciary nature [of the best interest] and more expansive operation of the duty'[144] is essential. As she opines, the best interest duty is 'the central fiduciary duty of directors, which operates as a catch-all duty. …'[145] Qualitative research by this author implies considerable informed community support. The present proscriptive/prescriptive typology is not useful to that community.

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[138] Langford, 'The duty of directors to act bona fide in the interests of the company', above n 101, 231.
[139] See below Figure 6.1.
[140] R P Austin, H A J Ford and I M Ramsay (eds), *Company Directors – Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) [11.1] cited in Langford, 'The duty of directors to act bona fide in the interests of the company', above n 101, 232; see especially Langford, *The Bona Fide Fiduciary Loyalty of Australian Company Directors*, above n 81, 313 [10.12], [5.3.1.1] citing *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64; 156 CLR 41 (Mason J, Gibbs CJ).
[141] Langford, *The Bona Fide Fiduciary Loyalty of Australian Company Directors*, above n 81, 314 [10.13].
[142] Ibid 313 [10.12].
[143] See above ch 3 (empirical analysis); below ch 5 (international comparative law); ch 6 (conclusions).
[144] Langford, 'The duty of directors to act bona fide in the interests of the company', above n 101, 242.
[145] Langford, *The Bona Fide Fiduciary Loyalty of Australian Company Directors*, above n 81, 313 [10.10].

Neither is it consistent with international trends or with comparative jurisdictions: Australian directors should note the 'unsatisfactory development of the law of fiduciary obligation in Canada and the US',[146] leading to the creation of 'new forms of civil wrong'.[147]

Lack of harmonisation of the law results in different obligations and liabilities in different jurisdictions in certain asset allocation decisions. As Ali insightfully notes, there is a conflict between modern portfolio theory and its reliance upon diversification to optimise performance, and the legal responsibilities of Australian fiduciaries which are similar but not the same as fiduciaries elsewhere. These include fund of fund investments (commonly used in alternate asset classes like hedge funds and private equity). 'The position in Australia regarding the delegation of trust powers (including investment powers) by fiduciaries … is in an unsatisfactory state.'[148] There is confusion. The general law on fiduciary delegations differs from the *Corporations Act*, *SIS Act*, *Fair Work (Registered Organisations) Act* and some comparative jurisdictions where the NBFE operates. A director of an RE may delegate investment power if it is prudent and the MIS constitution provides for it. A director of the corporate trustee of a superannuation entity may similarly delegate (but not abdicate) the investment power provided that there is ongoing and diligent monitoring of the delegatee. But the general law only permits delegation in 'cases of necessity'.[149] 'There is a real risk that a superannuation trustee, by committing trust funds to a Fund of Hedge Funds, will be considered to be in breach of its general law obligation to exercise trust powers personally.'[150]

The Global Fiduciary Standard is highly prescriptive requiring positive actions.[151] Similarly, the UN Fiduciary Duty in the 21st Century Program concludes: 'failing to consider all long-term investment *value* drivers, including ESG issues, is a failure of fiduciary duty'.[152] Necessarily, this implies positive actions. Australia may not have a choice.

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[146] *Westpac Banking Corporation v The Bell Group Ltd (in liq) [No3]* [2012] WASCA 157 [901] (Lee AJA).
[147] Ibid.
[148] Paul U Ali, 'Adding Yield to Stable Portfolios: Regulating Investments in Australian Hedge Funds' (2001) 19 *Company and Securities Law Journal* 427.
[149] Ibid 427.
[150] Ibid 429.
[151] See below ch 5, s 3.5.3.
[152] United Nations Environment Program 'Fiduciary Duty in the 21st Century' (2015) <http://www.unpri.org/download_report/6131>. This author's italics.

2.6 The confluence of director and trustee duties: when does a director assume trustee or additional fiduciary liability?

Every NBFE director should ask this question: there is not a simple answer. In Australian NBFEs, especially vertically integrated businesses, the answer is more often than directors may realise. Directors of corporate trustees of APRA regulated superannuation entities, of REs of unregistered or insolvent MIS, where there is a transfer of property by a fiduciary, cross-border asset allocation decisions, or where there are international business operations particularly involving US or Canadian entities may each find themselves subject to Australian trust law or fiduciary law of other jurisdictions. Directors of Australian resident foreign NBFEs and of Australian Government Owned Entities (GOEs) have additional legal overlays.[153]

> A trustee and a fiduciary have, distinctly, a duty to act 'in the interests (or best interests) of their respective beneficiaries' [where there is a fiduciary relationship].[154] 'The scope, even the independent existence of, this duty are matters of contest in private law … [with] no uniformly agreed and accepted understanding of what the description 'fiduciary powers' signifies in private law.[155]

The courts look at the context or the matrix of circumstances to identify the intentions of the parties. An express trust can exist if it is intended,[156] and the express term trust is used, or, if intention is not explicit, it can be imputed.[157] Many trusts are implied, inferred, or imputed based on the parties' intent.[158] '[T]he courts will recognize the existence of a trust when it appears from the language of

[153] Australian duties of care, diligence, good faith, use of information and position extend to directors and officers of a foreign company 'if the act or omission occurred in connection with the foreign company carrying on business in Australia; or an act that the foreign company does, or proposes to do in Australia, or a decision by the foreign company whether or not to do, or refrain from doing, an act in Australia.' See Mark Standen and Lysarne Pelling, 'Corporations Law: CLERP – how have directors' and officers' duties changed? (September 2000) 52(8) *Australian Company Secretary* 468; *Corporations Act 2001* (Cth) s 186. Earlier GOEs included Tricontinental, (Victoria) State Bank of South Australia, and Rothwells (Western Australia). See generally J Guthrie and M Gill, 'Following the Money Trail: Tricontinental and the Royal Commission' in P Weller (ed), *Royal Commissions and Public Policy* (Macmillan, 1994). In this earlier period, directors of public sector entities were afforded some statutory immunity in the exercise of their duties. Modern examples of state owned NBFEs include the Future Fund (Cth) and Queensland Investment Corporation. Modernisation of the statutes in respect of GOEs adopted private sector models of corporate governance and accountability. See Linda English and James Guthrie, 'An overview of Directors Obligations and Accountability Standards for Government Business Enterprises in the 1990's' (1996) *Australian Journal of Corporate Law* 120. As in the US, Australia follows concepts of 'public fiduciary responsibility … in informing and justifying standards of conduct'. See especially Finn, 'Public Trusts, Public Fiduciaries', above n 9, 338.
[154] Finn, 'Public Trusts, Public Fiduciaries', above n 9, 342.
[155] Ibid 342–3 citing Thomas, above n 108, 177; see also Lehane, above n 108.
[156] *Re Australian Elizabethan Theatre Trust* [1991] FCA 344; (1991) FCR 491 [502] (Gummow J).
[157] *Byrnes v Kendle* [2011] HCA 26; (2011) 243 CLR 253, 286 [103] (Heydon, Crennan JJ).
[158] Patrick Parkinson, 'Chaos in the Law of Trusts' [1991] 18 *Sydney Law Review* 231.

the parties, construed in its context, including the matrix of circumstances, that the parties so intended.'[159] Arguments for implied intention 'can be '"finely balanced"' … and raise "cautionary concern" about the certainty of that intention'.[160]

A director's fiduciary duty is not the same as the trustee duty, despite common provenance as fiduciaries. Breach of trustee duty exists separately in the general law and statute. Whilst there are 'numerous differences between the functions of a trustee and those of a director'…[161], there is nevertheless a degree of equivalence between the relationship of trustee and beneficiary and that of director and corporation not found in other fiduciary relationships'.[162] However, 'the duty of a director in equity to use reasonable care has developed a less onerous standard than that applied to a trustee'.[163] Exercise of trustee power for 'the proper purposes rule is not identical to the fiduciary best interest duty,[164] which only applies to fiduciaries.[165] Equitable fiduciary duties have been codified using language of the general law in the *SIS Act*, but subsumed piecemeal in the *Corporations Act*.

Directors need to be particularly careful as to context to avoid becoming a putative trustee. Remedial constructive trusts are a feature of the Australian landscape operating concurrently with statutory remedies.[166] '[T]here is still the potential for contrasting views in relatively settled areas of the law.'[167] 'The established rule that in order to constitute a trust the intention to do so must be clear and that it must also be clear what property is subject to the trust and reasonably certain who are the beneficiaries.'[168] Usefully as to the nature of inquiry a director should make:

> Unless there is something in the circumstances of the case to indicate otherwise, a person who has 'the custody and administration of property on behalf of others' or who has 'received, as and for the beneficial property of another, something which he has to hold, apply or account for specifically for his benefit' is a trustee in the ordinary sense.[169]

[159] *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* [1988] HCA 44.
[160] *Australian Executor Trustees (SA) Ltd v Korda* (2013) 8 ASTLR 454; The community at large is unlikely to appreciate these distinctions and can lead to the attempted use of supposed fiduciary principles by complainants sometimes in their attempts at unjust enrichment. See Harding, above n 121, 25.
[161] *Westpac Banking Corporation v The Bell Group Ltd (in liq) [No3]* [2012] WASCA 157 [848] (Lee AJA); *City Equitable Fire Insurance Co* [1925] Ch 407 [426] (Romer J).
[162] Ibid; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 [147]–[9] (Lord Russell).
[163] *Westpac Banking Corporation v The Bell Group Ltd (in liq) [No3]* [2012] WASCA 157 [851] Lee AJA.
[164] Thomas, above n 108, 191.
[165] Ibid 192.
[166] Leeming, above n 5.
[167] Nick Summerfield and Nathan Hodge, 'When is an express trust constituted? Korda v Australian Executor Trustees' (2015) 26 *Journal of Banking and Finance Law and Practice* 126.
[168] *Kauter v Hilton* [1953] HCA 95; (1953) CLR 86 [97].
[169] *Legal Services Board v Gillespie-Jones* [2013] HCA 35; (2013) 249 CLR 493 [523]–[524].

One hallmark of a trustee is to not mix other money with their own. A person is bound to keep the money in a separate account if they are a trustee, and they are trustees if bound to keep the money in a separate account.[170] Whether or not there is a constructive trust, or whether monies, separate or conjoined are in the nature of prepayments is a matter of judgment.[171] 'To require that a defendant must actually appreciate that the relevant facts constitute a trust in law would favour the legally ignorant over the legally aware, when the facts and knowledge are otherwise identical'.[172]

Subsequent conduct may also evidence the existence of a trust.[173]

> It may seem surprising that there might be uncertainty about whether there is a trust…[174] By the use possibly of unguarded language, a person may create a trust …[175] it is not enough for a court to consider that the implied term expresses what would have been reasonable for the parties to agree to. It must be satisfied that it is what the contract actually means.[176] Contractual obligations were sufficient…[177]

Thus, factual knowledge as to the contractual obligations is sufficient to establish liability, a lesser test than under trust law. For directors of corporate trustees of superannuation entities, there is a:

> complex and multi-layered mix of general law and statutory regulation[178] including general trust law, the *Corporations Act*, *SIS Act* [and *Fair Work (Registered Organisations) Act*]. The *SIS Act* has evolved to direct trustee-director responsibility to the beneficiary, consistent with general law principles. These have been (previously for the most part) 'accessorial in character'[,][179]

but that is not now the statutory position. This complex mix of duties may extend to officers, employees and agents of the corporate trustee.

[170] *Puma Australia Pty Ltd v Sportsman's Australia Limited (No 2)* [1995] 2 QR 159, 162.
[171] *Sino Iron Pty Ltd v Palmer* [2014] QSC 259 (Jackson J).
[172] *Sino Iron Pty Ltd v Palmer (No 3)* [2015] 143 QSC 94 [144] (Jackson J).
[173] Ibid (Jackson J).
[174] Ibid [56] (Jackson J).
[175] Ibid [58] (Jackson J).
[176] *Attorney General of Belize v Belize Telecom Ltd* [2014] HCA 32 (2014) ALR 356, 364 [22].
[177] *Sino Iron Pty Ltd v Palmer (No 3)* [2015] 143 QSC 94 [143] (Jackson J).
[178] Pamela F Hanrahan, 'Directors liability in superannuation trust companies' (2008) 2 *Journal of Equity* 204.
[179] Ibid 207.

2.7 Director and trustee liabilities for failures of fiduciary duty by others

'It was not necessary to know the "precise involvement" of Mr Cramer in the group's affairs in order to suspect that neither he nor anyone else had the right to use Barlow Clowes' money for speculative investments of their own'.[180]

A director can be responsible for the unknown breaches of fiduciary duty of other directors, advisers and contracting parties to those directors or the company. *Barnes v Addy*[181] (first and second limbs) liability can lead to serious consequences including the voiding of the directors' insurance policy. 'A breach of trust or a breach of fiduciary duty is at the heart of *Barnes v Addy* principles'.[182] Liabilities may extend to third parties,[183] who can become constructive trustees under the first limb.[184] Knowing receipt of property means any one of the Baden categories of knowledge.[185] Commercially, it may not be the director or trustee who is the real target, but a well-funded third party who permits their activities.[186]

Second limb director or trustee liability for breaches of fiduciary duties of fellow directors has three elements. These are: there must be dishonest and fraudulent breach of duty by the trustee or fiduciary (breach without dishonesty and fraud will not suffice); the trustee or fiduciary must have known of the dishonest breach of trust or fiduciary duty; and the trustee or fiduciary must have assisted in the dishonest breach of trust or fiduciary duty.

The concepts of knowledge and assistance or knowing assistance are heavily nuanced and can be fertile ground for a claim against a director, trustee, or other fiduciary using *Barnes v Addy* as authority. Knowledge is held to be:[187] actual knowledge; or, wilful ignorance; or, failing to make enquiry; or circumstances which would indicate the facts to an honest and reasonable person, or failure to recognise an impropriety that would have been apparent to an ordinary person with those standards; or knowledge of circumstances which would put an honest and reasonable person on

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[180] *Barlow Clowes International Ltd (in liq) v Eurotrust International Ltd* [2005] UKPC 37; [2006] WLR 1476, 1484 [28] (Lord Hoffman).
[181] *Barnes v Addy* (1874) 9 Ch App 251.
[182] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [1942] (Drummond AJA).
[183] *Selangor United Rubber Estates Ltd v Craddock* (No 3) [1968] 1 WLR 1555.
[184] *Belmont Finance Corp Ltd v Williams Furniture Ltd & Ors No 2* [1980] 1 All ER 393.
[185] *Baden Delvaux v Societe Generale pour Favouriser le Development du Commerce et de l'Industrie en France SA* [1992] 4 All ER 161; [1993] 1 WLR 509, 575–6 [250].
[186] Jackson, above n 28, 14.
[187] *Baden Delvaux v Societe Generale pour Favouriser le Development du Commerce et de l'Industrie en France SA* [1992] 4 All ER 161; [1993] 1 WLR509, 575–6 [250]; *Consul Development Pty Limited v DPC Estates Pty Ltd* [1975] HCA 8; (1975) 132 CLR 373.

enquiry. These Baden categories do not require actual knowledge but can be triggered by constructive knowledge, meaning context and the degree of enquiry. There does not need to be '"a guiding mind or minds"… that is, an identified person or persons of sufficient authority to bind their bank who were involved in committing the bank … and who had actual knowledge of the director's breach of duty'.[188] The scope of

> constructive knowledge is broad and can include: ought to have known; shut their eyes; failure to enquire; inference based on known facts; ignoring of warning signals; and buying of time. Indeed, knowing assistance: 'only has to show that the fiduciaries conduct has passed quite a low threshold before it can be categorised as involving a dishonest and fraudulent design'.[189]

'Whether the accessory acted dishonestly or with lack of probity is to be judged by objective standards'.[190] 'Again, one might justifiably question whether even the trained legal mind is capable of making such fine distinctions'.[191]

In *Imobiliari*, knowledge was further refined and nuanced:[192] intent; actual knowledge; recklessness, meaning a conscious disregard of a substantial and unjustifiable risk that the property was subject to a trust and was received pursuant to a breach of trust or of fiduciary duty or a misapplication of trust property; negligence; strict liability. The present position is that the minimum knowledge requirement is the test of recklessness.[193] But,

> I think this area of the law would be much improved if all the various categories were abolished and replaced with the simple rule that knowing receipt will be established where the plaintiff shows that the defendant acted recklessly … in receiving trust property that was misapplied or transferred in breach of trust or fiduciary duty.[194]

Fiduciaries cannot 'standby',[195] and professional advisers cannot participate in improper practices.[196] '[T]he morally obtuse cannot escape by failure to recognise an impropriety that would have been apparent to an ordinary person applying the standards of such persons'.[197] This settles the law in

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188 *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [2188] (Drummond AJA).
189 Ibid [2429] (Drummond AJA).
190 *The Hancock Family Memorial Foundation Ltd v Porteous & Anor* [1999] WASC 55 77 (Anderson J).
191 *Imobiliari Pty Ltd v Opes Prime Stockbroking Limited* [2008] FCA 1920 [29] (Finkelstein J).
192 Ibid.
193 Ibid [30] (Finkelstein J).
194 Ibid.
195 *Quince v Varga* [2008] QCA 376. On appeal from *Quince v McLaughlan* [2008] QSC 61.
196 *Lurgi (Australia) Pty Ltd v Ritzer Gallagher Morgan Pty Limited* [2007] VSC 277.
197 *Farah Constructions v Say-Dee Limited* [2007] HCA 22, (2007) 230 CLR 89, 163–4 [177].

Australia as to the second limb. However, 'it is impossible to say with any confidence just what the law in Australia as to knowledge (and notice as to first limb liability) is'.[198]

So directors may assume trustee-type liabilities as a result of becoming constructive trustees.[199] This can arise from 'knowledge or suspicion on his part of an improper or dishonest design in the transaction'.[200] Where there is a remedial constructive trust or institutional constructive trust, then the trustees have 'to account as defaulting fiduciaries would have been obliged to account'.[201] Declarations of constructive trust result in 'introducing equitable doctrine into the field of commerce … in appropriate cases it is necessary to allow equitable doctrine to penetrate commercial transactions.'[202] It is 'inappropriate to artificially constrict the concept of fiduciary relationship of that would deny equity's ability to do justice in appropriate cases'.[203] 'There are various interesting questions regarding the nature of a constructive trust and when it can be said to arise'.[204] 'The law of constructive trusts in this country [Australia] is 'ill-defined' (for my part, I would call it a mess)'.[205]

There must be trust property: a cause of dispute in many NBFE cases. The law is not only restricted to trust property. First limb liability can extend to the receipt of other forms of property including 'dispositions of company property made by a director in breach of his fiduciary duties to the company,'[206] not necessarily subject to any trust. *Barnes v Addy* liability is not 'confined to trustees in the strict sense of the term'.[207] Improper transfers of property by company officers to a third party who has knowledge of that misapplication are constructive trustees.[208] This is an evolution of the general law to other fiduciaries and 'in particular to company directors'.[209]

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[198] Jackson, above n 28, 28.
[199] *Barlow Clowes International Ltd (in liq) v Eurotrust International Ltd* [2005] UKPC 37; [2006] 1 WLR 1476 [10], [18] (Lord Hoffman).
[200] *Farah Constructions v Say-Dee Limited* [2007] HCA 22 [408] (Stephen J).
[201] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [1214] (Lee AJA).
[202] *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64 [100]; (1984) 156 CLR 41 (Gibbs CJ, Mason J).
[203] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [847] (Lee AJA).
[204] *Imobiliari Pty Ltd v Opes Prime Stockbroking Ltd* [2008] FCA 1920 [17] (Finkelstein J).
[205] Ibid [18] (Finkelstein J); citing *Muschinski v Dodds* [1985] HCA 78; (1985) 160 CLR 583, 595 (Gibbs CJ).
[206] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [2136] (Drummond AJA).
[207] Ibid [2137] (Drummond AJA).
[208] *Robins v Incentive Dynamics Pty Ltd (in liq)* [2003] NSWSC 71 [1] (Mason P, Stein JA, and Giles JA).
[209] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [2144] (Drummond AJA).

The property need not be tangible, but can include chose in action including intellectual property, patents, copyright,[210] confidential information,[211] and enforceable contractual rights.[212] The nature of chose in action has also expanded and now include rights arising under contract and the benefits therefrom.[213] 'The release of confidential information is a breach of trust by the trustee. The release contravened the Cbus trust deed … and … was a result of officers of the trustee having procured a breach of trust.'[214] This release of trust information was also a breach of contract and the *Privacy Act*.[215] Whilst the Heydon Royal Commission did not directly invoke *Barnes v Addy* general law liability,

> [t]he responses of Cbus and the CFMEU have involved wilful blindness. They have involved massive mendacity to the point of perjury … Cbus has made almost 'grovelling acknowledgments' that the executives were at fault. But those acknowledgments took a long time to emerge.[216]

2.8 Failure to inquire: fiduciaries looking the other way

Opes Prime[217] and a related entity, Leveraged Capital Pty Ltd entered into Securities Lending Agreements (SLAs) with their respective clients.[218] This was one of many cases involving conduct by so-called margin lenders where title to the underlying assets passed to the funding banks, often without the knowledge of the investors, many of whom were longstanding clients.[219] *Imobiliari Pty*

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[210] W S Holdsworth, 'The History of the Treatment of "Choses" in Action by the Common Law' (June 1920) 33(8) *Harvard Law Review* 997, 998.
[211] *Stephen John Coogan v News Group Newspapers Limited* (2012] EWCA civ 48 [30]–[39] (Lord Neuberger MR).
[212] *Zhu v The Treasurer of the State of New South Wales* [2004] HCA 56 [121]–[122] (Gleeson CJ, Gummow, Kirby, Callinan, and Heydon JJ) citing *Consul Development Pty Ltd v DP Estates Pty Ltd* [1975] HCA 8; 132 CLR 373 at 397 (Gibbs J).
[213] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [2157] (Drummond AJA).
[214] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 12, chs 7.1, 3 (Commissioner Heydon).
[215] *Privacy Act 1988* (Cth) s 16A.
[216] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 12, chs 7.1, 4 (Commissioner Heydon).
[217] *Lindholm, in the matter of Opes Prime Stockbroking Limited (Administrators appointed) (Receivers and Managers appointed)* [2008] FCA 1425 VID 245 [2] (Finkelstein J).
[218] As Finkelstein J noted in *Lindholm, in the matter of Opes Prime Stockbroking Limited (Administrators appointed) (Receivers and Managers appointed)* [2008] FCA 1425, this SLA was based on the 'standard form Australian Master Securities Lending Agreement (AMSLA) … which in turn was an adaptation, for Australian purposes, of the standard form Overseas Securities Lending Agreement'. (Now the Global Master Securities Lending Agreement published by the International Securities Lending Association). See also *Beconwood Securities Pty Ltd v Australia and New Zealand Banking Group Pty Ltd* [2008] FCA 594.
[219] *Primebroker Securities Limited v Christopher John Scott* [2015] VSC No S CI 2013 4962; *SC Capital Pty Ltd v Primebroker Securities Limited (in liquidation) (receivers and managers appointed*) SCV [2008] SCV 10548 (Efthim AJ).

Ltd v Opes Prime[220] sought to make 'the banks legally liable for the allegedly misleading conduct engaged in by Opes in connection with share lending transactions entered into with investors'.[221] Banks being knowingly concerned that Opes made misleading representation to investors that they retained the beneficial interests in the loaned shares could result in equitable[222] and statutory liability.[223] However, the 'elements of an express trust (intent, object of the trust, and beneficiary) were absent'.[224]

> Knowledge, being heavily nuanced and 'not explicitly settled by the High Court',[225] is nonetheless to be applied in this case as 'knowledge of facts that would put an honest and reasonable person on notice (but not merely inquiry) of a real and not remote risk that the transfer was in breach of trust or fiduciary duty or involved the misapplication of trust property' …[226] However, what that formulation means is debatable.[227]

In this, and other similar cases, there were regular commercial interactions between the funding banks (wholesalers) and the intermediaries, like Opes, which were the packagers or retailers of these financial products. Formulated legally,

> at best, the allegations would establish that the banks had knowledge of circumstances that would have put an honest and diligent person on inquiry. Or, to put it another way, the banks were negligent in failing to keep aware of what Opes was up to …[228] It is not an overly speculative leap from the proposition that the banks 'should have made due diligence inquiries' to the conclusion that, perhaps, the banks did make such inquiries from which they would have found out through readily available materials … what Opes was representing to investors …[229] The rejection of a duty of inquiry is effectively the rejection of a negligence standard …[230]

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[220] *Imobiliari Pty Ltd v Opes Prime Stockbroking Ltd* [2008] FCA 1920 (Finkelstein J).
[221] Ibid [1] (Finkelstein J).
[222] *Barnes v Addy* (1874) 9 Ch App 244.
[223] *Trade Practices Act 1974* (Cth) ss 52, 75B; *Corporations Act 2001*(Cth) ss 79, 1041H; *Australian Securities and Investments Commission Act 2001* (Cth) s 12DA. As Finkelstein J noted in *Imobiliari Pty Ltd v Opes Prime Stockbroking Ltd* [2008] FCA 1920 [19], 'Opes misled it [the client] into believing that it was opening a margin lending account (ie entering into share mortgage transactions where it retained beneficial ownership) rather than securities lending accounts (ie entering into straight sales where it gave up all ownership interests) and the bank both knew (or ought to have known) that it was being misled and actively went along with it'.
[224] *Imobiliari Pty Ltd v Opes Prime Stockbroking Ltd* [2008] FCA 1920 [25] (Finkelstein J).
[225] Ibid [27] (Finkelstein J).
[226] Ibid.
[227] Ibid [28] (Finkelstein J).
[228] Ibid [33] (Finkelstein J).
[229] Ibid [38] (Finkelstein J).
[230] Ibid [28] (Finkelstein J).

It should be expected that a diligent bank officer, and their risk committees, based on freely available public information and regular commercial interaction, would have known about the ultimate destination of their funds and the terms on which they were being deployed. A diligent financial institution should have studied the AMSLA, being very complicated commercial documents. Looking the other way should not excuse liability. Neither should overt conflicts of interest between NBFE director obligations to their clients and contractual obligations to the banks.

Rosenberg[231] is other evidence that the banks looked the other way in publicly acknowledged commercial arrangements between Opes and ASX listed Tricom Group.[232] 'Mr Rosenberg believed that Opes would, in turn, have on-lent many of these securities to its financiers'.[233] Opes' financial difficulties damaged Tricom and its clients, resulting in a 'need to take whatever action he could to recover the securities as soon as possible'.[234] 'Was Mr Rosenberg devious?'[235] No. He was in honest pursuit of his client's economic interests.

Directors cannot turn a blind eye to their fiduciary duties: *Elliott and Plymin.*[236] 'It is the directors who have a duty to oversee the whole management of the company. Only they should owe the duty to prevent insolvent trading…'[237] Individual directors have that duty personally.[238] There is no distinction between the duties non-executive and executive directors,[239] affirming other authorities. '[I]nactivity or the failure to "attempt" to prevent the company from trading or incurring the debt will be sufficient to constitute a failure to prevent the company from incurring the debt…'[240] The Santow principles,[241] were applied to a director who 'turned a blind eye to the details of Water Wheel's

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[231] *Rosenberg and ASIC* [2010] AATA 654 (R P Handley V-P).
[232] R P Handley V-P noted in *Rosenberg and Australian Securities and Investments Commission* [2010] AATA 654 [5]: In 2008 Opes lent Tricom considerable sums in return for 'a portfolio of securities "borrowed" from Tricom'. These involved the transfer of title to Opes under the AMSLA which also governed the relationship between Tricom and its clients.
[233] Being a major Australian and an international bank. *Rosenberg and Australian Securities and Investments Commission* [2010] AATA 654 [6] (R P Handley V-P).
[234] This resulted in allegations that he had 'failed to comply … with the Act … and had therefore failed to comply with a financial services law…, enlivening ASIC's banning power' (which ultimately failed). *Rosenberg and Australian Securities and Investments Commission* [2010] AATA 654 [21], [102] (R P Handley V-P)*; Corporations Act 2001 (Cth)* ss 1041B, 920A(1)(e).
[235] *Rosenberg and ASIC* [2010] AATA 654 [105] (R P Handley V-P).
[236] *Elliott v ASIC; Plymin v ASIC* [2004] VSCA 54 (Warren CJ, Charles JA, and O'Bryan AJA).
[237] Ibid [107] (Warren CJ, Charles JA, and O'Bryan AJA).
[238] *Corporations Law* s 588G; *Corporate Law Reform Act 1992* (Cth).
[239] *Elliott v ASIC; Plymin v ASIC* [2004] VSCA 54 [96] (Warren CJ, Charles JA, and O'Bryan AJA).
[240] Ibid [75] (Warren CJ, Charles JA, and O'Bryan AJA).
[241] *Re HIH Insurance Ltd; ASIC v Adler* [2002] NSWSC 483 (Santow J); *Corporations Law* s 1317 EA; *Corporations Act 2001*(Cth) s 206C.

liquidity crisis in the hope that “something would turn up” to rescue the company and his own associated financial interests’.[242]

2.9 Directors’ and trustees’ reliance on others

Daniels v Anderson[243] and *VBN v APRA*[244] (in the superannuation context) evolved the law. A director of a NBFE asserts competencies in addition to professional skills sets. It is these implied or overt assertions that investors rely upon in disclosure documents. ‘It turns on the natural expectations and reliance placed by shareholders on the experience and skill of a particular director [being] a common law duty to take reasonable care owed severally by persons who are fiduciary agents…’[245] The underlying distinction between what directors actually know and what they needed or ought to have known is the basis upon which non-executive directors have sought to excuse themselves. In modern practice, this is not sufficient. All directors can be liable for negligence and, if so, are tortfeasors.[246] Considerations of commercial complexity, board diversity, and the need for entrepreneurship can be lost in the responses to disclosure where investments have performed poorly or failed. This is no justification for ignorance or failure to inquire.

> If one feels that he has not had sufficient business experience to qualify him to perform the duties of a director, he should either acquire the knowledge by inquiry, or refuse to act. … The sentinel asleep at his post contributes nothing to the enterprise he is charged to protect. …[247] Directors are charged with keeping abreast of the bank’s business and exercising reasonable supervision and control over the activities of the bank … A director may not rely on the judgment of others. … Certainly, when an investment poses an obvious risk, a director cannot rely blindly on the judgment of others …[248] a director’s duty to exercise due care, skill and diligence in overseeing the affairs of the bank cannot be met solely by relying on other persons.[249]

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[242] *Elliott v ASIC; Plymin v Australian Securities and Investments Commission* [2004] VSCA 54 [182] (Warren CJ, Charles JA, and O’Bryan AJA).
[243] *AWA Ltd v Daniels t/a Deloitte Haskins & Sells* (1992) 7 ACSR 959; 10 ACLC 933; *Daniels and others formerly practising as Deloitte Haskins & Sells v AWA Ltd* (1995) 37 NSWLR 438; 13 ACLC 614.
[244] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 (S A Forgie V-P, B H Pascoe).
[245] *Daniels and others formerly practising as Deloitte Haskins & Sells v AWA Ltd* (1995) 37 NSWLR 438 [505] NSWCA (Clarke JA, Sheller JA, and Powell JA).
[246] Ibid.
[247] *Francis v United Jersey Bank* 432 A2d 814 (NJ 1981) [821]–[823].
[248] *Federal Deposit Insurance Corporation v Bierman* 2 F3d 1424 (7th Cir) 1993 USCA (7th Cir) [1432]–[1433].
[249] *Federal Deposit Insurance Corporation v Stanley* 770 F Supp 1281 (ND Ind 1991) [1310].

Whilst a US case, these same standards apply to directors in Australia.[250]

In *Vines* (the GIO case), directors and senior executives also engaged and relied upon prominent third party advisers.[251] Statutory liability rested with the target company, its directors, and some expert advisers. These statutory liabilities were based on belief in the reasonableness of the truth and adequacy of the disclosures, without an 'express requirement to make reasonable enquiries or conduct due diligence',[252] other than for misleading statements.[253] Nonetheless, 'general law standards of care and diligence of company directors and officers are relevant and highly persuasive … to the interpretation of the statutory standard'.[254] 'I would not be justified in … setting the standard of care at a lower and less demanding level than the general law'.[255]

In *Healey* (the Centro case), directors are 'entitled to seek assistance in carrying out their responsibilities and may rely on others,'[256] including declarations by the CEO or CFO.[257] This reliance is limited so as 'not to detract from the responsibilities otherwise imposed upon directors'.[258] Responsibility for the financial report and the directors' report rests with the directors. Directors must take 'all reasonable steps'[259] to comply with the declaration requirements and compliance with the financial records and financial reporting requirements. It is not sufficient to delegate these duties to others 'since directors are part of the process themselves by undertaking the task of approving and adopting the financial statements and reports'.[260]

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[250] *Daniels and others formerly practising as Deloitte Haskins & Sells v AWA Ltd* (1995) 37 NSWLR 438 [503] NSWCA (Clarke JA, Sheller JA, and Powell JA).
[251] As Austin J noted in *ASIC v Vines* [2005] NSWSC 738 [188]: 'All of them participated in their respective roles in the formal due diligence and verification process established by the board including the final version of the Part B statement (which included a profit forecast). An insight into the culture of at least one of these third party advisers should remind directors not to rely without challenge on their advice: "undertaking a due diligence process was unnecessary because no Part B Statement had ever been litigated". In any event, the law required the construction and publication of a Part B Statement. The formal due diligence process is not unlike that for the issuance of new securities, although the statutory framework is different. A Part B statement must: "set out any material changes since the date of the last financial statements, and any other information which material to the making of a decision by an offeree whether or not to accept the offer, being material known to any of the directors and not previously disclosed"'. *Corporations Law* s 750 Part B [12]–[13].
[252] *ASIC v Vines* [2005] NSWSC 738 [1081] (Austin J).
[253] *Corporations Law* s 995(2); *Trade Practices Act 1974* (Cth) s 52.
[254] *ASIC v Vines* [2005] NSWSC 738 [1096] (Austin J).
[255] Ibid.
[256] *ASIC v Healey (No 1)* [2011] FCA 717 [129] (Middleton J).
[257] Ibid [130] (Middleton J).
[258] Ibid [131] (Middleton J).
[259] *Corporations Act 2001*(Cth) s 344.
[260] *ASIC v Healey (No 1)* [2011] FCA 717 [142] (Middleton J).

What should directors actually do? What does all reasonable steps mean in practice? It means an objective analysis of each case: 'the standard requires, at a minimum, that directors take a diligent and intelligent interest in the information either available to them or which they might appropriately demand from the executives or other employees and agents of the company'.[261] Whilst this standard is derived from consideration of insolvency cases, the law is replete with references to the adjective reasonable.

'These duties do not mean that directors must reach every decision on the basis of their own knowledge, expertise and skills'.[262] Directors must reasonably inform themselves as to the matter upon which they must make a judgment. This inevitably requires reliance on others (including employees, fellow directors in committee or otherwise, professional advisers): care needs to be taken to meet the statutory test of such reliance[263] to ensure that statutory duty[264] in respect of the standard of care are met together with equivalent duties in common law and equity.[265] The reliance must be made in good faith and after making an independent assessment of the information or advice and the directors reliance is reasonable 'unless the contrary is proved'.[266] These tests require the application of time and financial resources which relate directly to the directors contract of engagement. They are cumulative tests, and failure to comply may render ineffective a defence under the business judgment rule.[267]

2.10 Business judgment of directors and officers in disclosure cases

Australia's regulatory environment relies heavily on disclosure: to capital markets, investors, and for sound corporate governance. Disclosure is often a matter of business judgment. It is extremely dangerous for directors to rely on other directors, management, and advisers in matters of disclosure. Disclosure can be matters of historic facts, embellished or ignored; it can be assessments of the future, an uncertain and risky proposition, subject to manipulation. A determination whether 'the impugned conduct is found to be a mere error of judgment'[268] becomes enormously important since it does not

[261] Ibid [143] (Middleton J).
[262] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [501] (S A Forgie V-P, B H Pascoe)
[263] *Corporations Act 2001* (Cth) ss 180(2), 189.
[264] Ibid s 180(1).
[265] *Westpac Banking Corporation v The Bell Group Ltd (in liq) [No3]* [2012] WASCA 157 [866] (Lee AJA).
[266] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [501] (S A Forgie ,V-P B H Pascoe); *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [864] (Lee) AJA.
[267] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [869] (Lee AJA).
[268] *ASIC v Healey (No 1)* [2011] FCA 717 [192] (Middleton J) citing *ASIC v Vines* [2006] NSWSC 738; (2005) ACSR 617 [1075].

trigger contravention of the Act.[269] 'In the period between the introduction of the business judgment rule in 2000 and the case of *ASIC v Rich* in 2009 … [it] had not successfully been invoked.'[270]

Judicial interpretation of the BJR illustrates director conflicts between entrepreneurship and bondage. There is no consistency of application. The *Corporations Act* s 180(3) defines business judgment broadly including relevant matters of commission and omission. Directors cannot look the other way or remain in unminuted silence and achieve BJR protection. Broad statutory definition is not consistent with a safe harbour. Conversely, 'what is intended as a safe harbour for honest business decisions that turn out badly … does not imply lesser standards in making an informed decision'.[271] Additionally, judicial opinion countenances an overlay of duty of care standards which 'reflect[s] contemporary community expectations'.[272]

'[I]t is not achieving the purpose of protecting the authority of directors in the discharge of their duties, nor has it led to legal clarity regarding director liability'.[273] The tensions occur in disclosure and reliance upon others assisting in those disclosures.[274]

> 'Ambiguous', 'confusing', and 'opaque', … [i]f the drafting of the BJR is decidedly 'confusing' from the perspective of a Supreme Court Justice, it has no doubt been unable to provide certainty to the directors who seek to rely on it …[275] [T]here was no protection of the authority of directors in exercising their judgment to rely upon management and experts.[276]

Storm Financial non-executive directors were insufficiently knowledgeable of the Storm client base to make informed assessments of the Storm business model on its clients including the reasonableness of the advice given:

> Australian company legislation since 1958 has clearly recognised a public character to the duty in s 180(1) ... [and] plainly continues to treat a contravention of s 180(1) as both a public and private wrong. …[277] This 'public duty [may] exist[s] independently … [and] is owed to the public at large.

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[269] *Corporations Act 2001*(Cth) s 180(1).
[270] Michael Legg and Dean Jordan, 'The Australian Business Judgment Rule After ASIC v Rich: Balancing Director Authority and Accountability' (2014) 34 *Adelaide Law Review* 403, 407.
[271] John Farrar and Pamela Hanrahan, *Corporate Governance* (LexisNexis Butterworths, 1st ed, 2017) 229.
[272] *ASIC v Healey (No 1)* [2011] FCA 717 [192] (Middleton J) citing *ASIC v Rich* [2003] NSWSC 85 [358] (Austin J).
[273] Jenifer Varzaly, 'Protecting the authority of directors: an empirical analysis of the statutory business judgment rule' (2012) 12(2) *Journal of Corporate Law Studies* 461.
[274] Matthew Hooper, *The Business Judgment Rule: ASIC v Rich and the reasonable-rational divide* (2011) <http://epublications.bond.edu.au/cgej/22>.
[275] Varzaly, above n 272, 445 quoting *ASIC v Rich* [2009] NSWSC 1229 (Austin J).
[276] Ibid citing *ASIC v Hellicar* [2012] HCA 17.
[277] *ASIC v Cassimatis (No 8)* [2016] FCA 1023 [455] (Edelman J).

> …'[278] It is a 'question of high level theory'[279] cognisant of broader directors' duties 'expressed generally'[280] and 'harm to any of the interests of the corporation',[281] including its reputation. [C]assimatis' duty to consider *Storm's* interests when managing the corporation does not require a narrow construction of *Storm's* interests limited only to the interests of its shareholders … Storm's interests should not be construed narrowly.[282]

These judicial sentiments reflect community expectations of their business leaders and their assumptions of fiduciary protections. Both remain unmet and are statutorily unresolved.

Healey identifies several deficiencies requiring statutory remedy. It also illustrates the inter-relationship between s 180 and corresponding registered MIS s 601FD[283] provision where there is no safe harbour protection. Errors of judgment can readily occur where the availability, volume, timeliness, and volatility of board papers is not properly controlled by the board. 'The complexity and volume of information cannot be an excuse for failing to read and understand the financial statements'.[284] The agenda for this board meeting, the accounts for which were signed only two days after management had completed them, 'were still being considered by the auditor and were subject to changes'.[285] The versions of the accounts available to the directors were volatile in content, available without appropriate time for proper consideration, and then only in a location which may not be a suitable environment for diligent study.

> The non-executive directors had not been given sufficient time to review the final accounts prior to the meetings …[286] It is clear that: (a) drafting and consideration of the full financial statements of CPL continued up to and after the accounts were signed … and (b) there are differences between the notes in the full financial statements of CPL as compared with the CPL concise financial statements.[287]

[278] Ibid [460] (Edelman J).
[279] Ibid [469] (Edelman J).
[280] Ibid [470] (Edelman J).
[281] Ibid [480] (Edelman J) citing *Vrisakis v Australian Securities Commission* (1993) 9 WAR 395 Ipp J.
[282] Ibid [478] (Edelman J).
[283] *Corporations Act 2001* (Cth) s 601FD(1)(b).
[284] *ASIC v Healey (No 1)* [2011] FCA 717 [229] (Middleton J). Centro board practice involved some 450 pages made available in a location for review.
[285] Ibid [279] (Middleton J).
[286] Ibid [283] (Middleton J).
[287] Ibid [344] (Middleton J).

These procedural failures led to '[e]rrors were so obvious that it can readily be inferred that it was negligent for the directors to have failed to detect them'.[288] '[I]n my opinion it is analogous to a fraud case by reason of the very serious allegations that have been made against each of the directors.'[289]

Each director failed:

> [T]o take the following steps that a reasonable person would have taken if they were in the director's position.[290] 'Each … director failed to make enquiries of management …[291] This was not 'mere technical oversight',[292] but the errors in the financial statements were so obvious that breach of the standard of due care and diligence is the inescapable conclusion to be drawn by the court …[293] More than a mere 'going through the paces' is required for directors.[294]

There were foreseeable consequences arising from misclassification of liabilities and failure to disclose corporate guarantees likely to lead to a loss of confidence. '[T]he role of a director is significant as their actions may have a profound effect on the community';[295] 'in determining liability of a defendant as company chairman, is to articulate and apply a standard of care that reflects contemporary community expectations'.[296] Informed decisions were impossible, not mere mistakes, breaching s 180(1), eliminating recourse to s 180(2) and providing statutory, fiduciary and tortious grounds for breach of business judgment.

Similarly, in *Hellicar* where conflicting judicial inference was required to interpret directors' unminuted silence:

> Some directors breached their duties by 'voting in favour of the resolution without either asking for a copy of the announcement or knowing its terms, or by failing to abstain from voting in favour of approval of the announcement' …[297]

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288 Ibid [566] (Middleton J).
289 Ibid [544] (Middleton J).
290 Ibid [583] (Middleton J).
291 Ibid [577] (Middleton J).
292 Ibid [10] (Middleton J).
293 Ibid [251] (Middleton J).
294 Ibid [19] (Middleton J); *Daniels v Anderson* (1995) 37 NSWLR 438.
295 *ASIC v Healey (No 1)* [2011] FCA 717 [14] (Middleton J).
296 Ibid [192] (Middleton J) quoting *ASIC v Rich* [2003] NSWSC 85 [358] (Austin J).
297 In *ASIC v Hellicar* [2012] HCA 17 [17]–[25] (French CJ, Gummow, Hayne, Crennan, Keifel and Bell JJ) the court noted JHIL established the Medical Research and Compensation Fund (MRCF) to compensate people injured by exposure to asbestos products. This fund was stated to have 'sufficient funds to meet all legitimate compensation claims anticipated from people injured. … That was a fateful and dangerous statement. It turned out to be false to a very considerable degree … the directors of JHIL ought to have known that these statements about MRCF's funding were misleading in four particular respects. Neither the finding that the statements were misleading in each of those respects, nor the finding that the directors ought

Directors were in breach of duty of care,[298] enlivening s 180(2) without the benefit of its provisions. A defence based on false records, of whatever provenance opens directors to significant criminal penalties and reputational discredit.[299]

Fortescue Metals provides insight into the commercial realities of disclosing cross-border transactions involving different business cultures, common in NBFEs. For unlisted NBFE securities disclosure is governed by contract and statute, not on a continuous disclosure basis required by ASX. These disclosures can be opaque, if not misleading. ASX obligations point more broadly to disclosure policy for NBFEs. Whether Framework Agreements were contracts or an agreement to agree affects their continuous disclosure requirement. 'Those trading in Fortescue Metals[300] securities had been seriously misinformed about the affairs of the company'.[301] Even if, 'by reason of serendipity, shareholders made a gain'[302] that does not permit directors to ignore their continuous disclosure obligations.

When does an agreement to agree or agreements to negotiate where there are no legally enforceable obligations require continuous disclosure and to what extent in exercising judgment, is a director able to rely on the statutory business judgment provision?[303] Would 'an ordinary and reasonable person, being a member of the investing public'[304] believe that the publicly announced agreements be binding in material sense?

> The decision not to disclose the true effect of the 'Framework Agreements' cannot be described as 'business judgment' at all. A decision not to make accurate disclosure of a major contract is not a decision related to the 'business operations' of the corporation. Rather, it is a decision related to compliance with the requirements of the Act[305] … It can reasonably be inferred that he [Forrest] knew

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to have known that the statements were misleading, was put in issue in this Court. … The management and the directors were acutely conscious of the sufficiency question. Minutes of the board meeting were later claimed by the directors to be a false record of that meeting. To find that the minutes of a company listed on the ASX were false in so important a respect was a serious matter legally and commercially. It is fundamental to the running of so large and important an organisation as JHIL. …The meeting in question "may have been the most significant in the company's history". … The announcement made to the ASX was subject to change, but the changes made by others, despite their protestation, was "not significant" and "did not alter the fundamental meaning of what was said"'.

[298] *Corporations Act 2001*(Cth) s 180(1).
[299] Ibid ss 1307(1), 1308(2),(4); *ASIC v Hellicar* [2012] HCA 17 [300]–[303] (Heydon J).
[300] *ASIC v Fortescue Metals Group (No 2)* [2011] FCAFC 68 (Finkelstein J).
[301] Ibid [232] (Finkelstein J).
[302] Ibid [233] (Finkelstein J).
[303] *Corporations Act 2001*(Cth) s 180(2).
[304] *ASIC v Fortescue Metals Group (No 2)* [2011] FCAFC 68 [99] (Finkelstein J).
[305] Ibid [197] (Keane CJ, Emmett and Finkelstein JJ).

> of the disparity between these terms and FMG's representations about them[306] … It is not an intention lightly to be attributed to the legislature that a director of a company might lawfully decide, as a matter of business judgment that a corporation under his or her control should not comply with a requirement of the Act.[307]

'This Australian business judgment provision does 'not authorise conduct which involves the contravention of a specific provision of the Act … especially where the Act provides a specific ground of defence in relation to that provision'.[308] The non-disclosure of the Framework Agreements may have resulted in pecuniary penalty to FMG, enlivening breach of the statutory duty of care. The High Court disagreed, finding no breach of s 180(1) so no failure of disclosure that constituted a business judgment for the purposes of s 180(2).[309]

In *Adler*, directors were found to have made no business judgment or failed to satisfy s 180(2) or had a personal interest,[310] thereby having no business judgment defence. They, separately, 'went well beyond a mere error of judgment' … 'committ[ed] a serious breach of s 180' … and indulged in 'conduct of the utmost folly'.[311] *Howard*,[312] a related case:

> By failing to act in the interests of the corporation, preferring his own interests … he abused the trust that had been placed in him. He acted out of greed. … At a time when [he] should have exhibited character, he had none.[313]

In *Rich*, contravention of directors statutory duties of care and diligence were divided into two classes: 'corporation/schemes' and 'financial services'.[314] A series of cases illustrating the tension created by 'statutory compromise between two competing policy objectives…'[315] resulted in judicial concern that 'the placement of the onus of proof on the director ensures that the elements of the directors decision – contrary to the very purposes of a business judgment rule – are subject to judicial

[306] Ibid [191] (Keane CJ, Emmett and Finkelstein JJ).
[307] Ibid [198] (Keane CJ, Emmett and Finkelstein JJ).
[308] Ibid [46] (Keane CJ, Emmett and Finkelstein JJ).
[309] *Forrest v ASIC* [2012] HCA 39; (2012) 246 CLR 486 cited in Farrar and Hanrahan, above n 270, [14.28].
[310] Farrar and Hanrahan, above n 270, [14.30].
[311] *ASIC v Adler* [2002] NSWSC 483 [144]–[154] (Santow J).
[312] As David Kirby J noted in *R v Howard* [2003] NSWSC 1248 [16]–[60]: 'a great temptation in these circumstances for those involved to sit tight and to close ranks: a policy as one of "encouraging dishonour amongst thieves" … Despite the dire situation of HIH, this did not preclude a professional employee from accepting 'an inducement to breach his duty to the corporation for which he worked, … a corrupt "kick-back"'…
[313] *R v Howard* [2003] NSWSC 1248 [45] (David Kirby J).
[314] *Corporations Act 2001*(Cth) s 1317DA; *Financial Services Reform Act 2001* (Cth) amend 2002.
[315] *Rich v ASIC* [2004] HCA 42; *ASIC v Rich* (2009) FLR 1.

scrutiny'.[316] This is contrary to the legislative intent and US ALI practice. There must also be proof of 'rational belief'[317] in the best interests of the company.

Having a rational belief is a different test from what constitutes objective best interest required in s 181. To some extent, s 180(2) is inconsistent with a directors' duty to act objectively in the best interest of the company, not just a belief, rational or not. It conflicts with the objective standard for REs of MIS in s 601FD, and is more akin to the belief (not rational belief) standard applying to registered organisations, themselves companies. Similarly, the broad statutory definition of business judgment is silent on director silence. Subjectivity is overlain with judicial interpretation of inconsistent and evolutionary community expectations. The authors' qualitative research suggests those expectations may have fiduciary rather than duty of care origins. Consequently, despite legislative intent, the BJR, judicially emasculated, applies if at all, on subjective bases, with the onus of proof on the director: in many cases impeded by directors' self-immolation. And then only when the company is not an RE or corporate trustee.

2.11 The only Certainty is Uncertainty

In *Kinghorn,*[318] a finding of corrupt conduct depended upon his essentially passive role in failing to disclose information.

> [It] depended upon such non-disclosure constituting an offence … involving conduct of a director or other officer of a corporation which is recklessly or intentionally dishonest, and failing to exercise the powers and discharge the duties of a director in good faith and for a proper purpose …[319] the Commission has some interest in having an appellate court resolve the proper construction of s 184(1) of the *Corporations Act*…[320]

Can a director engage deliberately in a conduct knowing that it was not in the best interests of the company? Can the aversion of a personal loss or detriment constitute the gaining of an advantage? Is

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[316] Legg and Jordan, above n 269, 417.
[317] *Corporations Act 2001*(Cth) s 180(2)(d).
[318] *Duncan v ICAC McGuigan v ICAC Kinghorn v ICAC Cascade Coal v ICAC* [2014] NSWSC 1018 (McDougall J); *ICAC v Kinghorn* [2015] NSWCA 342 (Bathurst CJ, Basten JA, Meagher JA).
[319] *ICAC v Kinghorn* [2015] NSWCA 342 [24] (Bathurst CJ, Basten JA, Meagher JA).
[320] Ibid [31] (Bathurst CJ, Basten JA, Meagher JA); *Duncan v ICAC McGuigan v ICAC Kinghorn v ICAC Cascade Coal v ICAC* [2014] NSWSC 1018 [159] (McDougall J); Good faith in the exercise of directors duties involves 'at least four aspects: an exercise of powers or duties in the interests of the company, in the sense of not misusing or abusing those powers, avoidance of conflicts between personal interests and those of the company, a prohibition on taking advantage of the position to make secret profits, and a prohibition on the appropriation of the company's assets for their own benefit. The concept of a "proper purpose" in this part of company law has been understood to mean much the same thing as "good faith"'. *Corporations Act 2001* (Cth) s 184(1).

a '"failure to exercise powers" a separate head of criminality, and 'acting in good faith for the best interests of the corporation' a separate head of duty'?[321]

For conduct to be dishonest means 'dishonest according to the standards of ordinary people'.[322]

> to observe the proscriptive obligations imposed on fiduciaries, it may be necessary for a fiduciary to perform some positive act. But that does not mean that there is a prescriptive element to the fiduciary duty. It means that, to avoid a conflict of interest (or avoid profiting at the expense of the beneficiary), it is necessary for the fiduciary to take some positive step.[323]

Kinghorn and *VBN* are insightful for those NBFE directors dealing with regulatory authorities. There can be considerable uncertainty and risk. The Independent Commission Against Corruption (ICAC) published an adverse report on alleged corrupt conduct by directors which 'was not made according to law and is a nullity'.[324] 'The plaintiffs were denied natural justice because they were unable to respond to the cases against them'.[325] The State (NSW) struck back:[326] 'The amendment was to operate retrospectively, with the consequence that the legal basis upon which the Commission had conceded that its appeal with respect to Mr Kinghorn must be dismissed was no longer the law'.[327]

2.12 Equitable compensation for breaches of fiduciary duty

The principles of causation for equitable compensation for breach of fiduciary duty are clear. There must be 'criteria which supply an adequate or sufficient connection between the equitable compensation claimed and the breach of fiduciary duty'.[328] 'What constitutes adequate or sufficient connection is not predetermined or formulaic'.[329] In breaches of trust where a trustee is dealing with trust property, the law has evolved further and there are 'stringent tests to the selection of those events preceding the loss which are to be taken as causing the loss'.[330] Compensation payable for 'breaches

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[321] *Duncan v ICAC McGuigan v ICAC Kinghorn v ICAC Cascade Coal v ICAC* [2014] NSWSC 1018 [174] (McDougall J).
[322] Ibid [164] (McDougall J); *Crimes Act 1900* NSW s 192.
[323] *Duncan v ICAC McGuigan v ICAC Kinghorn v ICAC Cascade Coal v ICAC* [2014] NSWSC 1018 [205] (McDougall J).
[324] Ibid at Decision (McDougall J).
[325] Ibid [44] (McDougall).
[326] *Independent Commission Against Corruption Amendment (Validation) Act 2015* (NSW).
[327] *ICAC v Kinghorn* [2015] NSWCA 342 [4] (Bathurst CJ, Basten JA, Meagher JA).
[328] *ABN Amro Bank NV v Bathurst Regional Council* [2014] FCAFC 65 [1090] (Jacobsen, Gilmour, and Gordon JJ) citing *Maguire v Makaronis* [1997] HCA 23.
[329] Ibid [1090] (Jacobsen, Gilmour, and Gordon JJ).
[330] Ibid [1091] (Jacobsen, Gilmour, and Gordon JJ) citing *O'Halloran v R T Thomas & Family Pty Ltd* [1998] NSWSC 596 (276).

of fiduciary duty is assessed based on loss at the time of the trial with the full benefit of hindsight'.[331] Trustees may also be required to compensate for foregone usage of money. The 'general principle is that where a trustee has, through his breach of trust, occasioned loss to the trust estate then he is liable to make good that loss, together with interest'.[332]

[331] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 [260]–[261] (Rares J).
[332] *Spangaro v Corporate Investment Australia Funds Management Ltd (No 2)* [2003] FCA 168 [4] (Finkelstein J).

3. EVOLUTION AND MEANING OF THE BEST INTEREST DUTY

3.1 Statutory and general law: variance as to the interpretation of the best interest duty

Best interest is a commonly used and misunderstood phrase interpreted differently in the law, media, legislature and throughout the NBFE investment chain. For investors, best interest can be confused with oft-misguided concepts of undivided loyalty to their own economic interests, sometimes conflated with Messianic leadership.

Directors and trustees apply the phrase without understanding its differing interpretations, sometime glibly; others give it lip service. Honesty alone is not a sufficient discharge of trustee duty: there must also be objective process. That process differs with varying interpretations of best interest. For example, best interest in Australian investment decisions conflicts with modern portfolio theory. Best interest in financial advice varies with adviser and recipient. The law is complex, often uncertain, and lags comparative jurisdictions.

There are multiple and differing interpretations of best interest in the *Corporations Act*,[333] *SIS Act*,[334] and the *Fair Work (Registered Organisations Act).*[335] General law interpretations, fiduciary or otherwise add to the confusion. The *Corporations Act*[336] requires directors to act in good faith in the best interests of the corporation and for a proper purpose. There is no qualification as to belief, as there was in the *Fair Work (Registered Organisations) Act*[337] until amended in December 2016 still echoed in the rational belief requirement in *Corporation Act* BJR s 180(2).[338]

The *Corporations Act* has the higher standard fiduciary duty of good faith: it requires objective evidence that directors act in in the company's best interest.[339] However, directors can be in breach of fiduciary duty, having acted honestly and in the belief that the act is in the company's interests unless they can demonstrate an objective standard. Further, '"interests of the company" and "best interests" of the company' are not necessarily the same, but could be'.[340] Superannuation entity trustees are subject to the same general law obligations as those in a traditional trust, traditionally the

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[333] *Corporations Act 2001* (Cth) ss 180(2)–184, 961B(1)(2), 601FC, 601FD. See below ch 6 tab 6.1.
[334] *Superannuation Industry (Supervision) Act* 1993 ss 52(2), 52(8), VN(a)–(b).
[335] *Fair Work (Registered Organisations) Amendment Act 2016* (Cth).
[336] *Corporations Act 2001* (Cth) s 181.
[337] *Fair Work (Registered Organisations) Act 2009* (Cth) s 382.
[338] See below ch 6, tab 6.1 for comparative analysis.
[339] Standen and Pelling, above n 153, 466.
[340] *Pioneer Concrete Services Pty Ltd v Yelnah Pty Ltd* (1986) 11 ACLR 108.

interests of the members rather than their best interest.[341] The *SIS Act* now extends this definition of best interest for MySuper default funds to best (long term) financial interest.[342] In MIS,

> [t]he meaning of the phrase 'best interests of the members …[343] has not previously been the subject of judicial consideration and accordingly I have given it special attention'. …[344] The 'best interests of the members' is determined by the particular context in which a specific trust operates. … The scheme constitution governs the trustee in the exercise of the powers and duties, subject to relevant equitable principles and statutory provisions. … Where, as here, the trust deed forms part of a contractual agreement it is all of the more sacrosanct because the law of contract is added to the law of trusts. …[345] Directors should heed the general law further since it is difficult to discern the outer boundaries of the best interests duty and 'the statute alone does not make clear where the boundary lies' and it is appropriate to consider the meaning of the term under general law.[346]

Best interests in their statutory formulations[347] are not defined. As Donald has identified, general law phraseology of variable interpretation was applied in the statutes. This uncertainty is compounded by the more recent extension of superannuation covenants to directors of their corporate trustees personally, hence the need of trustee directors to pay homage to the boundaries of the general law. '[T]he case law directly interpreting and applying the relevant provisions is scant'.[348] An important distinction between the duties of a superannuation entity trustee and an RE MIS directors duty is that trustees are 'required to engage with the issues they face, and not merely to ensure they have a pre-defined process has been followed accurately, or in the vernacular, that all the boxes have been ticked'.[349] This is not necessarily so for directors of an RE. 'While the RE model emphasises the importance of compliance arrangements, that is quite different from performance and it is worth examining whether an independent trustee (or other) model would provide greater oversight and be better at resolving inherent conflicts of interest'.[350] This would return Australia to pre-1998 regulation.

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[341] Donald, '"Best" interests?', above n 103, 250; see *Locke v Westpac* (1991) 25 NSWLR 593.
[342] *Superannuation Industry (Supervision) Act* (Cth) ss 29VN(a)–(b).
[343] *Corporations Act 2001* (Cth) ss 601FC(1), 601FD(1).
[344] *ASIC v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liquidation) (Controllers appointed) (No 3)* [2013] FCA 1342 (12 December 2013) [455] (Murphy J).
[345] Ibid [460] (Murphy J).
[346] Ibid [463] (Murphy J).
[347] *Corporations Act 2001* (Cth) ss 601FC(1)(c), 961B(1), 961B(2), 180(2)(d); *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(2);
[348] Pamela F Hanrahan, 'The relationship between equitable and statutory "best interests" obligations in financial services law' (2013) 46(1) *Journal of Equity* 7 [V].
[349] M Scott Donald, 'Prudence under pressure' (2010) 4 *Journal of Equity* 44, 1.
[350] Christine Brown, Colm Trusler, and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern failure'(2010) 2 *JASSA The Finsia Journal of Applied Finance* 27.

The heritage of the best interest duty lies in equity. This means a fiduciary duty to give undivided loyalty to the beneficiaries and 'trustees must do the best they can for the beneficiaries and not merely avoid harming them'.[351] Meaning: 'a combination of the established duties'[352] rather than 'a distinct and separate duty … not an obligation to act in a way which the trustee honestly considered to be in their interests, but a positive obligation to act in what are, objectively, their interests'.[353] However, the best interest duty is 'relevant to the exercise of a dispositive trust or power but not to its existence'.[354] The trustees' duty of undivided loyalty is 'the most fundamental duty of a trustee'.[355] 'The duty of loyalty is, then, the fruit of the courts' efforts to regulate the behaviour of trustees when their duties as trustees require them to act in ways that may or do conflict with their own personal interests'.[356] Hence, the best interests duty

> is an 'umbrella' duty which embraces a large number of individual, well recognised duties[357] which is in addition to other trustee duties and includes 'pursuit of the best possible authorised end or outcome for the trust as a whole but also the observance of proper procedures and processes in decision making'.[358]

So whilst a trustee may not actually achieve the best possible outcome for the beneficiaries, the trustee must act objectively, not just honestly, in striving to achieve that result. Trustees' duties may only be impugned where there are later and adverse consequences for the beneficiaries.[359] In *Prime Trust*, the directors were held to have acted honestly in their belief constitutional amendments were valid,[360] and had not breached the *Corporations Act*,[361] despite 'the controlling operative and directive minds in respect of the process…'[362]

> The obligations of trustees outside this statutory context [*Corporations Act*] would not authorise a trustee to act in accordance with a purportedly amended trust deed if it was invalidly amended … [the RE] caused the constitution to be amended … [and] paid trust money to itself upon the basis that the

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351 *Cowan v Scargill* [1985] Ch 270, 295 (Sir Robert Megarry V-C).
352 Lehane, above n 108, 38.
353 Ibid 37.
354 Thomas, above n 108, 190.
355 Mark L Ascher, Austin Wakeman Scott and William Franklin Fratcher, *Scott and Ascher on Trusts* (Wolters Kluwer Law & Business, 5th ed, 2007) 1077.
356 Ibid 1079.
357 *ASIC v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liquidation) (Controllers appointed) (No 3)* [2013] FCA 1342 (12 December 2013) [475] (Murphy J).
358 Ibid.
359 Donald, 'Prudence under pressure', above n 349, 5.
360 *Lewski v ASIC (No 2)* [2017] FCAFC 171 [48–49] (Greenwood, Middleton, and Foster JJ).
361 *Lewski v ASIC* [2016] FCAFC 96 [347] (Greenwood, Middleton, and Foster JJ).
362 *Lewski v ASIC (No 2)* [2017] FCAFC 171 [75] (Greenwood, Middleton, and Foster JJ).

> amendments were effective. At no stage was member approval for the amendments to the constitution sought.[363]

Prime Trust is an exemplar of the *Corporations Act* subsuming trust law, facilitating box-ticking value shifting conduct in defiance of the spirit of the general law, arguably acting against the best interest of the members. Such value extraction by related parties strikes at the heart of investor confidence and the veracity of all Australian MIS.

There is considerable subjectivity defining the interests of the company and the exercise of power for a proper purpose. It is 'the directors who make business decisions and courts have traditionally not pronounced on the commercial justification for those decisions'.[364] However, whether or not the directors have complied with the law will be determined objectively. 'The issue is as to the director's state of mind'.[365] The best interest duty requires standards of conduct which underpin the role of a fiduciary who are required 'to do the job you were asked to do (and only that job) but also to do it properly'.[366] Meaning: proper procedural elements in trustee decisions are as important as the achievement of the best outcomes for the beneficiaries based on the knowledge of the time, not in hindsight.[367]

With court widening of interested stakeholder groups, 'whether the "best interests" of the company as a whole reflect those of the shareholders in the light of the corporate objects, or those of the creditors which will prevail in the context of insolvency…'[368] 'The court must consider the interests of the company as a whole'.[369] This includes the assessment of whether a directors 'state of mind' in a conflict of interest situation warrants examination,[370] and the 'prospects of success of the action'.[371] It might be that it is not in the

> best interests of the company where the directors decide that that is the case and all of the directors who have participated in that decision acted in good faith and for a proper purpose, did not have a material interest in the decision, properly informed themselves about the subject matter of the decision to the extent they reasonably believed was appropriate and rationally believed that the decision was in

[363] Ibid [190] (Greenwood, Middleton, and Foster JJ).
[364] *The Bell Group Ltd (in liq) v Westpac Banking Corporation* (*No9*) [2008] WASC 239 [4619] (Owen J).
[365] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [1988] (Drummond AJA).
[366] Thomas, above n 108, 193.
[367] *Nestle v National Westminster Bank plc* [1993] WLR 1269 (Dillon J). See generally Lisa M Butler, 'The super standard of care – How high should superannuation trustees jump? (2008) 2 *Journal of Equity* 225.
[368] *In the matter of Gladstone Pacific Nickel Limited* [2011] NSWSC 1235 [57] (Ball J).
[369] Ibid.
[370] *Corporations Act 2001* (Cth) s 236 defines who can bring proceedings rather than reliance on general law.
[371] *In the matter of Gladstone Pacific Nickel Limited* [2011] NSWSC 1235 [57] (Ball J).

> the best interest of the company. A belief is a rational one unless the belief is one that no reasonable person in the position of the directors would hold.[372]

The statutory best interest duty of financial advisers to their client is different to that of directors of the corporate trustee of a MIS. It is different again for directors of registered organisations (traditionally a lesser test) and for directors of trustees of superannuation entities where there is statutory personal liability to the beneficiary. Community expectations of best interest which prima facie confer fiduciary status may be different again. Custodians, depending on their contractual arrangements, may or may not have a best interest duty. Comparative jurisdictions have other interpretations of best interest. Industry consolidation and vertical integration (especially involving financial advice, wealth management, corporate advice, securities broking, investment managers, and custodians) further complicate the duties of directors and trustees and deepen the expectations chasm between them and their clients, beneficiaries and investors, particularly where those persons may be vulnerable.

3.2 Is best interest a fiduciary duty?

The best interest duty, in its differing manifestations,[373] has its heritage in equity and can only be properly exercised in general law by fiduciaries adopting the undivided loyalty standard. *Ipso facto*, those exercising best interest duties are exerting fiduciary powers. Context indicates that the best interest duty as applied by fiduciaries can indeed be fiduciary in character despite statutory and some general law constraints.

Fiduciaries may be status based (directors, trustees, agents) or contractors (financial planners in general law). Status based fiduciaries are subjected to positive statutory extensions of their duty conferring nexus between fiduciary and beneficiary (in APRA regulated superannuation) and member (in MIS). These statutory best interest provisions accorded fiduciaries are positive, prescriptive and sometimes discretionary. They operate concurrently with proscriptive no-conflict, no-profit without informed consent rules under statute and general law and with non-fiduciary duties including duty of care. Nonetheless, the statutory duties are essentially 'fiduciary'.[374]

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[372] Ibid; *Corporations Act 2001* (Cth) s 237(3).
[373] See below ch 6, tab 6.1. See also M Scott Donald, '"Best' Interests' (2008) 2 *Journal of Equity* 245, 254.
[374] *Alpha Wealth Financial Services Pty Ltd v Frankland River Olive Company Ltd* [2005] WASC 189 [33] ['Alpha Wealth'].

Some statutory intervention (and contract) has corrupted and subsumed the application of that fiduciary standard, particularly in MIS and retail financial advice. Where there is no statutory remedy for best interest failure, unregistered MIS for example, resolution is usually provided in equity.

3.3 Best interest in investment strategy

As Donald notes, performance and appropriateness are both important objective criteria where there is no statutory definition of 'investment strategy'.[375] 'Courts are unlikely to be sympathetic towards trustees whose lack of diligence or care exposes their trust to uncompensated risks'.[376] Risk is the corollary of return: prudence is not the absence of risk. These risks include valuation information from investment vehicles devoid of transparency (eg hedge and private equity funds, funds of funds). 'Direct investment by trustees into such [alternative] investments raises the "due diligence" bar very high indeed'[377] with a 'dramatic increase in the work required prior to and after investment to satisfy (and be seen to satisfy) the trustees' duty of care'[378] Trustees of Australian superannuation entities must follow the prudent superannuation trustee standard in each discrete investment decision. That it may not result in optimal investment portfolio performance for the fund by the standards of modern portfolio theory is not relevant to the decision, resulting in further uncertainty.[379] For NBFEs with operations in the US, Canada, and the UK, this is not the case.[380] Their law has evolved so that 'prospective investments should be considered not in isolation from other investments, but rather in the context of the overall risk level of the fiduciary's investment portfolio.'[381]

In the absence of a statutory definition of investment strategy,[382] 'those responsible for the management of investment portfolios, such as trustees and their agents, are acutely worried that their actions will be judged with the benefit of hindsight or without regard for the portfolio context'.[383] 'Due diligence' is subjective and can 'connote different things to different people'.[384] Given the complexity of modern superannuation funds, many MIS, and the self-immolation in Australia's corporate governance there is generally not the skills sets available at board level without

[375] Donald, 'Prudence under pressure', above n 349, 9.
[376] Ibid 9.
[377] Ibid 10.
[378] Ibid 9. See also D'Angelo, 'Private equity investing by financial institutions', above n 93, 311.
[379] Paul U Ali and Martin Gold, 'An overview of "Portable Alpha" Strategies, with Practical Guidance for Fiduciaries and some Comments on the Prudent Investor Rule' (2001) 19 *Company and Securities Law Journal* 276.
[380] *Nestle v National Westminster Bank plc* [1993] WLR 1269 (Dillon J).
[381] Ali, above n 148, 426.
[382] Donald, 'Prudence under pressure', above n 349, 9.
[383] Ibid 8–9.
[384] Ibid 9.

considerable reliance upon third party advisers. 'Trustees need to ensure that the terms of reference, taken together, address the issues comprehensively'.[385] For completeness, given the temptations of hindsight and the asymmetry of fiduciary duties, independent review of the advice, both for accuracy and efficacy as understood in trust law would be prudent despite the additional costs.

Best interests of the trust are not necessarily the same as best interests of specific beneficiaries and the best interest duty allows trustees to not perform an action.[386] Best interest relies upon the purposes of the trust and what benefits were intended to be conferred on the trusts' beneficiaries.[387] It may mean 'best financial interest',[388] in which case choice of investment options (rather than default options) in superannuation products may expose trustee directors to claim arising from poor investment choices by the beneficiary.[389] Trustee selection of asset allocation choices therefore needs to be carefully considered and external political and societal pressures for particular asset classes ignored. Best financial interest may mean long term financial interest requiring trustee responsibility for asset liquidity, beneficiary longetivity, and other market-linked risks.

For trustees administering MySuper products, there are additional requirements. These include a prescriptive duty to 'promote the financial interests of the beneficiaries',[390] and 'determine on an annual basis whether the beneficiaries are disadvantaged in comparison to beneficiaries of other funds holding a My Super product.[391] Trustees need to contemplate whether to advise beneficiaries to transfer to competing funds, a substantial extension of their statutory best interest duty. The extension of statutory superannuation corporate trustee director liability to the members personally[392] adds considerably to the risk associated with being a director of a superannuation corporate trustee.

'The relationship between statutory provisions and the general law … is much more problematic ... likely to tax the cognitive powers of its subjects just as surely as they impose a cost burden on them'.[393]

> What 'the interests' of aggrieved persons may be and how they ought to be protected are matters incapable of categorisation or of precise definition. Indeed, it would have been folly

[385] Ibid.
[386] Thomas, above n 108, 186; *Rouse v IOOF Australia Trustees Ltd* (1999) 73 SASR 484, 499–500.
[387] *Corporations Act 2001* (Cth) ss 181(1), 601FC(1)(c), 601FD(1)(c); *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(2)(c).
[388] Donald, '"Best" interests?', above n 103, 256.
[389] Ibid 271.
[390] *Superannuation Industry (Supervision) Act 1993* (Cth) s 29VN.
[391] Donald, 'Regulating for fiduciary qualities of conduct', above n 6, 150.
[392] *Superannuation Industry (Supervision) Act 1993* (Cth) ss 52A(d), 55A(4A).
[393] Donald, 'Regulating for fiduciary qualities of conduct', above n 6, 159.

> on the part of the legislature to attempt to define or limit what interests should be protected or how: to do so would have been to ignore the sad reality that the ingenuity of fraudsters is inexhaustible, their snares for the gullible pitiless and of infinite variety, and the eagerness of the foolish to be parted from their money irrepressible.[394]

A 'bitter pill'.[395] But nonetheless restored directors to the status the directors had as if APRA had never made its disqualification decision. *VBN v APRA* disquieted directors and trustees: the operation of the statutory best interest covenants[396] undermined their putative general law duty.[397]

> The Directors had relied on the legal and actuarial advice they had received. No action had been taken against the professional advisers who had proferred that advice … and yet the Trustee and its Directors were said to be derelict in performing their roles. … [398] Whilst professional advice is essential … the Trustees obligation goes beyond simply seeking, accepting and following professional advice. The *SIS Act* and Regulations clearly require those Directors and so the Trustee, to use their own acumen, knowledge and judgment in weighing all relevant factors including professional advice.[399]

Meaning, a trustee director following professional investment advice can still be in breach of the statutory covenants. Statutory liability is strictly personal. A trustee can, as with companies that are not trustees, make specific delegations to a committee of directors, or a director, but the trustee duty remains with the entity as a whole.[400]

3.4 Best interest in financial and investment advice

This discussion of interests, however defined, does not address the systemic problem of the gap between customer or investor expectations and market practices in financial services advice or financial products selling. Reasonable expectations of financial advice and its implementation may give rise to an equitable fiduciary relationship in personalised financial advice,[401] but is facts

[394] *Australian Securities and Investments Commission v Bridgecorp Finance Ltd* [2006] NSWSC 836 [17] (Barrett J) citing *Australian Securities and Investments Commission v Mauer-Swiss Securities Ltd* [2002] NSWSC 684 (Palmer J).
[395] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 (S A Forgie V-P, B H Pascoe).
[396] *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(2).
[397] Donald, '"Best" interests?', above n 103, 252.
[398] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [469] (S A Forgie V-P, B H Pascoe).
[399] Ibid.
[400] *Superannuation Industry (Supervision) Act 1993* (Cth) ss 52(3), 59(1).
[401] Hanrahan, 'The relationship between equitable and statutory "best interests" obligations in financial services law', above n 348, [11].

specific.[402] 'The precise content of that obligation is in every case, including that of each financial services firm, particular to the nature of the undertaking from which the fiduciary obligation springs'.[403] It may spring from the initial contact with a putative client 'advice about advice', before providing the statutorily controlled[404] 'substantive advice'.[405]

Much rests upon the Wallis inspired principles of disclosure and client ability to properly provide informed consent, both of which are subjective tests.

> Mere disclosure of this information may not be enough to establish the level of fully informed consent that equity requires. The client must understand the impact of what is being disclosed in its position and its relationship with the financial services firm, and must give its consent (express or implied) to the existence of that conflict or collateral advantage … the firm has the onus of proving that it obtained the client's fully informed consent to its obtaining any benefit, or acting when it had a conflict in, that relationship. The burden in equity is high, particularly where the client is unsophisticated.[406]

This echoes but is a different and lesser obligation than the German civil law doctrine of *culpa in contrahendo* being positive ex ante action requiring client comprehension which cannot be contracted away. Australian informed consent law is not a positive fiduciary duty — 'the existence of an informed consent goes to negate what otherwise would be a breach of [fiduciary] duty.'[407] The fiduciary must be in receipt of or obtain informed consent, but the obtaining of it is not a fiduciary duty. That process will depend on context, often in contract.[408]

Many of these issues would disappear if the financial planning industry were separated into those that provide professional advice and those that sell financial products.[409]

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[402] Ibid [111] citing *Maguire v Makaronis* [1997] HCA 23; 188 CLR 449 at 467 (Brennan CJ, Gaudron, McHugh and Gummow JJ).
[403] Ibid [V1].
[404] *Corporations Act 2001* (Cth) s 961B(2).
[405] Simone Degeling and Jessica Hudson, 'Fiduciary obligations, financial advisers and FOFA' (2014) 32 *Companies and Securities Law Journal* 527; Simone Degeling and Jessica Hudson, 'Equitable money remedies against advisers who give "advice about advice"' (2015) 33 *Companies and Securities Law Journal* 166.
[406] Ibid [111].
[407] *Maguire v Makaronis* [1997] HCA 23; 188 CLR 449 at 467 (Brennan CJ, Gaudron, McHugh and Gummow JJ).
[408] See, eg, *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* [2007] FCA 963; *ABN Amro Bank NV v Bathurst Regional Council* [2014] FCAFC 65; *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028.
[409] Kevin Lindgren, 'Fiduciary duty and the Ripoll Report' (2010) 28 *Company and Securities Law Journal* 443.

> A bank may be expected to act in its own interests in ensuring the security of its position as lender to its customer, but it may have created in the customer the expectation that nevertheless it will advise in the customer's interests as to the wisdom of a proposed investment. This may be the case where the customer may fairly take it that to a significant extent his interest is consistent with that of the bank in financing the customer for a prudent business venture. In such a way, the bank may become a fiduciary and occupy the position of what Brennan J has called an investment adviser.[410]

There has been a common expectation by financial products investors seeking financial advice that there is a relationship based in fiduciary principles. Part of the mismatch in expectations has been poor financial literacy and misunderstanding of the law, but part is innate trust assumed by investors in professional persons with whom they deal.

> Where a bank gives a customer advice upon financial affairs, then in addition to any contractual rights the customer may have, the relationship between the parties may be such as to found either, or both, a common law duty of care and a fiduciary duty.[411]

'Generally, the degree of care required under a contractual obligation to exercise reasonable skill and care is different from the reasonable prudence that a person in a fiduciary position must exercise'.[412]

Many banks (often through their controlled entities) provide advice on investments. 'A person offering personal advice to a retail client 'must act in the best interests of the client in relation to the advice'[413] The

> duty is to furnish the client with all the relevant knowledge which the adviser possesses, concealing nothing that might reasonably be regarded as relevant to the making of the investment decision' and 'to give the best advice which the adviser could give if he did not have but a third party did have a financial interest in the investment to be offered, to reveal fully the adviser's financial interest, and to obtain for the client the best terms which the client would obtain from a third party if the adviser were to exercise due diligence on behalf of his client in such a transaction.[414]

This applies in other NBFEs.

> Normally, the relationship between a stockbroker and his client will be one of a fiduciary nature and such as to place on the broker an obligation to make the client a full and accurate disclosure of the

[410] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 [733] (Rares J); citing *Daly v Sydney Stock Exchange Ltd* [1986] HCA 25.
[411] *Commonwealth Bank of Australia v Smith* [1991] FCA 375.
[412] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 [900] (Rares J).
[413] Hanrahan, 'The relationship between equitable and statutory "best interests" obligations in financial services law', above n 348, 71.
[414] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 [741] (Rares J).

> broker's own interest in the transaction. … The duty arises when, and because, a relationship of confidence exists between the parties.[415]

Variance from these duties requires the fiduciary to obtain fully informed consent from their client. 'What is required for a fully informed consent is a question of fact in all of the circumstances of each case and there is no precise formula which will determine in all cases if fully informed consent has been given'.[416]

'The duties and obligations that Australian financial services firms owe to their clients derive from a complex set of rules and principles arising in common law (particularly contract and tort), equity (including fiduciary principles) and statute'.[417] Whilst financial services businesses are not recognised as status-based fiduciaries, and financial planners have no statutory fiduciary duty, the obligations are specific to the context in which financial services are provided and the contracts under which they are provided.

> Where both the equitable and statutory obligations apply, the statutory duties do not displace the equitable principles … [and] may well impose different (and more onerous) obligations on financial services firms than the statutory duties…[418]

The statutory best interest duty in financial advice is prescriptive,[419] including seven measures, and requires an appropriateness test for retail clients.[420] These are 'highly relevant to the Court's assessment of compliance with the best interest duty'.[421] They add to concepts of fiduciary duty in the same case, perhaps even subsuming them.[422] 'It is likely to be many years before the courts can interpret the content of the duty … will take many years and many cases before it is clear how the best interest duty operates[423] … and greatly complicates the existing regime of protections'.[424] 'There does not appear to be any detailed consideration of the provisions that are the subject of this

[415] Ibid [739] (Rares J).
[416] Ibid [742] (Rares J).
[417] Hanrahan, 'The relationship between equitable and statutory "best interests" obligations in financial services law', above n 348, 72.
[418] Ibid 73.
[419] *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth) s 961B; *Corporations Act 2011* (Cth) s 961B(1).
[420] *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth) s 961G.
[421] *ASIC, in the matter of NSG Services Pty Ltd* [2017] FCA 345 [18] (Moshinsky J).
[422] Donald, 'Regulating for fiduciary qualities of conduct', above n 6, 142.
[423] Corones and Galloway, above n 104, 5.
[424] Ibid 9.

proceeding',[425] whilst applying Santow principles for breaches of them.[426] Whilst the origin of the best interest duty is in equity and is fiduciary-like, the statutory duty in retail financial advice is prescriptive and procedural. It may act to reduce or eliminate client equitable remedies.

> [T]he statutory best interest provision is a long way from what equity understands the 'best interest' concept to mean, on even the narrowest view of that understanding. … The statutory best interest obligation is expressed as a series of steps to be undertaken, not as an obligation to prefer the client's interest over the firm's or to avoid the situations of conflict or collateral damage that fiduciary law proscribes … [and is] a significant departure from the best interest obligations that apply in equity to financial advisers.[427]

It is process driven, not outcome driven, provides a safe haven for advisers,[428] does not fulfil its original policy objectives of statutory fiduciary duty and therefore does not meet community expectations of what the law should mean. These include fiduciary obligations of undivided loyalty of financial and corporate advisers to their clients, and restorative remedies for breach. It further entrenches the doctrine of prioritisation over prohibition. '[I]t may operate to limit existing duties of financial advisers … apparently contrary to the intention of the post-GFC reforms'.[429] Subsequent testing in 2017 provides the proof: 100% of advisers in the sample relied on the statutory safe harbour provision. 75% of those advisers claiming reliance on it did not comply with their statutory best interest duty with 10% leaving their client in a worse financial position.[430] This is damning evidence of the subsuming of general law fiduciary obligation by compromised statute.

Expectations of fiduciary obligation create a false sense of security which is not met in practice. They arise from the politicisation of the debate: it is a sop, reflected in parliamentary commentary of the time. Accretive statutory change has bizarre results:

> the new law applies to some financial services firms who are not fiduciaries with respect to the giving of that advice at general law. However, because of the narrow definition of retail client, many financial

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425 *ASIC, in the matter of NSG Services Pty Ltd* [2017] FCA 345 [30] (Moshinsky J).
426 *ASIC, in the matter of Golden Financial Group Pty Ltd (formerly NSG Services Pty Ltd) v Golden Financial Group Pty Ltd (No 2)* [2017] FCA 1267 [18] (Moshinsky J).
427 Hanrahan, 'The relationship between equitable and statutory "best interests" obligations in financial services law', above n 348, [V].
428 *Corporations Act 2001* (Cth) s 961B(2)(a)–(g).
429 Hanrahan, 'The relationship between equitable and statutory "best interests" obligations in financial services law', above n 348, [V].
430 ASIC, *Financial advice: Vertically integrated institutions and conflicts of interest* (Report 562, January 2018) [151]–[152].

advisers who are fiduciaries (for example, the advisers in *Wingecarribee* and *Bathurst*[[431]]) are not subject to the new law.[432]

Further complication is added by the statutory distinction between liabilities to the employer resulting from their representatives and Authorised Representatives for whom 'there is no equivalent provision',[433] these definitional problems stemming in part from s 9 of the *Corporations Act*.[434]

Statutory reform has materially evolved the nature of regulation of financial products and financial services that largely subsume general law principles even as they employ similar language. 'We live in the 'Age of Statutes'.[435] Insightfully, the intrusion of statute 'is all too evident in both the FoFA and Stronger Super reforms. It is manifest in the sheer number of provisions that have been required to achieve a small number of easily articulated objectives'.[436] 'The provisions relating to the prohibition of certain types of "conflicted remuneration" are particularly Byzantine'.[437]

[431] *ABN Amro Bank NV v Bathurst Regional Council* [2014] FCAFC 65 (Jacobson, Gilmour and Gordon JJ).
[432] Hanrahan, 'The relationship between equitable and statutory "best interests" obligations in financial services law', above n 348, [V].
[433] *ASIC, in the matter of NSG Services Pty Ltd* [2017] FCA 345 [26] (Moshinsky J).
[434] *ASIC v Citigroup Global Markets Australia Pty Limited (ACN 113 114832) (No 4)* [2007] FCA 963 (Jacobsen J).
[435] Dimity Kingsford Smith, 'Is "due diligence" dead? Financial Services and products disclosure under the Corporations Act' (2004) *22 Company and Securities Law Journal* 130.
[436] Donald, 'Regulating for fiduciary qualities of conduct', above n 6, 142 [3].
[437] Ibid [1].

4. FAILURES OF BEST INTEREST DUTY BY FIDUCIARIES

4.1 Financial advice

4.1.1 Fiduciary duty to wholesale clients with retail financial literacy competencies

'Abandon all hope, ye who enter here'.[438] Wingecarribee Shire Council and other Australian local authorities, '*Wingecarribee*'[439] and their compatriots in the UK and the US passed through these gates of hell. They suffered losses arising out of their acquisition of synthetic[440] collateralised debt obligations (CDO) and credit default swaps (CDS), collectively (Dante Notes).[441]

'These products took hundreds of closely typed legally dense pages to document'.[442] 'A professional, in Grange's position, does not discharge any duty of disclosure or adequately explain a complex transaction merely by giving its client a copy of voluminous documentation and inviting the client to look at it, unaided by the professional…'[443] Grange, on inquiry was 'hardly candid' about its remuneration, and its answers were 'calculated to mislead and deceive'.[444]

> I do not accept Grange's characterisation of its mere references in its selling materials to other documents that contained the full terms and conditions, including risk disclosures, as an attempt to provide the Councils, as clients, any substantive assistance to understand the underlying issues that may have affected the Councils' investment decision-making. These documents were of a 'byzantine', or as Lord Mance said 'purgatorial' complexity.[445]… Grange had an obligation to make a full and accurate disclosure of its interest in the transaction and all that Grange knew with respect to the product, concealing nothing that might conceivably be regarded as relevant to the making of the investment decision.[446]

None of the Councils had officers with any significant experience in financial products of this complexity. The Councils may have statutory typology of wholesale investors, but decision makers,

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[438] Allen Mandelbaum (trans), *The divine comedy of Dante Alighieri: Inferno* (Bantam Books, 1980).
[439] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq*) [2012] FCA 1028 (Rares J).
[440] Synthetic means the arranging bank does not incur credit exposure.
[441] *Lehman Brothers Holdings Inc v City of Swan* [2010] HCA 11. These products were sold by Lehman Bros Australia Ltd (Grange Securities Ltd) as adviser. Other advisers selling similar financial products included ABN Amro, Westpac, ANZ, Macquarie Financial Services, Local Government Financial Services, and Commonwealth Bank: *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq*) [2012] FCA 1028 [1109] (Rares J).
[442] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq*) [2012] FCA 1028 [3] (Rares J).
[443] Ibid [340] (Rares J).
[444] Ibid [945] (Rares J).
[445] Ibid [118] (Rares J); citing *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012]1 AC (UK) 383 429 [138].
[446] Ibid [728] (Rares J) citing *Daly v Sydney Stock Exchange Ltd* [1986] HCA 25.

drawn from the community, had retail financial literacy competencies.[447] The Dante Notes were also the subject of litigation in the UK and the US. In the UK, the noteholders were given priority to collateral.[448] In the US the result was the opposite, with the issuer having priority.[449] The result being:

> [A]s a result of certain conflicting claims and on-going legal proceedings, no distributions can be made to the holders of the Notes at this time …[450] It will be some time before the United States Courts decide whether to follow the decision of the Supreme Court of the United Kingdom…[451]

'This legal uncertainty'[452] compounded the decision of the trustee to not make a distribution of collateral to the noteholders. The FCA approved a settlement for the Councils in December 2015.

The central feature of these legal relationships was a contract, the terms of which did not qualify the fiduciary character of the relationship, equity superimposing fiduciary obligations as an incidence of the relationship. 'Indeed, the equitable remedies for a failure to discharge a fiduciary obligation may be greater than those available in the contract'.[453] Pointing to the need for statutory reform:

> Grange had engaged in deceptive and misleading conduct contrary to what is now a plethora of pointlessly technical and befuddling statutory provisions scattered over many Acts in defined situations. The repealed, simple and comprehensive s 52 of the *Trade Practices Act 1974* (Cth) that prohibited corporations engaging in misleading or deceptive conduct in trade or commerce has been done away with by a morass of dense, difficult to understand legislation. Those Acts, that now deal with misleading and deceptive conduct, apply differently depending on distinctions such as whether the alleged misleading conduct is in relation to a 'financial product or a financial service',[454] or 'financial services'.[455] Those apparently simple terms are nothing of the sort. A 'financial product' is defined in mind-boggling detail in 7 pages of small type[456] while a 'financial service' takes another 6 pages to be defined.[457] The *ASIC Act* only takes about 4 pages to define 'financial service'.[458]

[447] Grange promoted itself as a financial adviser with specific expertise in local government capital management, advising 85 Councils in New South Wales, 40 in Victoria, and 12 in Western Australia. Local government was a vertical in marketing parlance. Rares J in *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 [32] noted that Grange asserted 'a detailed understanding of the local government market that was unmatched in the financial markets'.
[448] *Perpetual Trustee Co Ltd v BNY Corporate Services Ltd* [2012] 1 AC (UK) 383.
[449] *In re Lehman Bros Holdings* Inc 422 BR (USA) 407 (2010).
[450] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 [834] (Rares J).
[451] Ibid [839] (Rares J).
[452] Ibid [841] (Rares J).
[453] Ibid [729]–[730] (Rares J).
[454] *Corporations Act 2001*(Cth) s 1041H(1).
[455] *Australian Securities and Investment Commission Act 2001* (Cth) s 12DA(1).
[456] *Corporations Act 2001*(Cth) pt 7.1, div 3.
[457] Ibid pt 7.1, div 4.
[458] *Australian Securities and Investment Commission Act 2001* (Cth) s 12BAB.

> Obviously, there are differences in what each of these Acts and definitions cover – but why? The cost to the community, business, the parties, and their lawyers, and the time for courts to work out which law applies have no rational or legal justification.[459]

Quite so: the Ascent into Uncertainty which continues: 'the application of the provisions defining financial products and financial services in this [*Corporations Act*] and other acts is often the cause of unnecessary distraction and confusion…'[460]

Wingecarribee also pointed to another statutory reform need; there is no prudential supervision of Australian NBFEs other than insurance and superannuation entities.[461] Grange could not meet its obligations to the Councils.

Dante notes, on Grange's admission, were

> suitable only for financial institutions and highly sophisticated professional investors who are capable of understanding … and who can absorb a substantial or total loss of principal. The Term Sheet is not intended for distribution to, or use by, private customers … such as the Councils.[462]

What is the distinction between a financial product seller and the provision of financial product advice?[463] This question arises constantly in NBFE financial product and financial advice markets for all typologies of investors. Peer professional opinion on this distinction is neither universal nor consistent.[464] A redefinition of *Corporations Act* investor typology is needed.

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459 *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq*) [2012] FCA 1028 Summary 3 (Rares J).

460 *Australian Securities and Investments Commission v Davidof* [2017] FCA 658 [4] (Lee J).

461 Grange was undercapitalised and unable to operate a secondary market for its clients. The Councils were deprived of liquidity in these investments. Grange did not inform its clients of this problem. Undisclosed, Grange controlled the secondary market and certain related party fee structures from which it was able to derive margins. The result, as Rares J noted in *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq*) [2012] FCA 1028, the products were 'risky, illiquid, and if sold, might realise far less than their face value, but also that Grange was conscious that the trust its uninformed Council clients had placed in it was being used to Grange's advantage'.

462 Ibid [339]–[340] (Rares J).

463 Lesa Bransgrove, 'Case Note: Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq) [2012] FCA 1028' (2013) 24 *Journal of Banking and Finance Law and Practice* 52 [65].

464 Ibid citing *Civil Liability Act 2002* (NSW) s 5O(1) which 'excluded liability for negligence for acting in a manner that at the relevant time was widely accepted by peer professional opinion as competent practice'.

Bathurst[465] was a similar case, being a triumph of promotion over the prudent investment of public funds. 'Rembrandt was a grotesquely complicated product'[466] Their Honours opined:

> LGFS had a lengthy history of interactions with the NSW Councils and wanted them to feel 'a strong relationship' with it. …[467] Its 'corporate strategy was to develop a relationship of trust and confidence' and become 'their trusted adviser' …[468] LGFS knew that the Councils were 'peculiarly vulnerable'[469] arising from limited internal financial literacy in respect of these products and 'the high degree of trust'[470] known to be placed in LGFS by the Councils … LGFS expected and intended that, in making a decision to invest, the Councils would rely on LGFS advice… [471] and did not want the [C]ouncil officers to get advice from anyone else about the product.[472]

LGFS 'was in a fiduciary relationship with each Council and, in its dealings with the Councils, LGFS breached its fiduciary obligations to avoid conflicts of interest in respect of the notes, or to disclose and obtain fully informed consent to such conflicts'.[473] LGFS was no mere salesman: factually it acted in a fiduciary capacity.

S&P's assignment of a AAA rating was 'misleading and deceptive and involved the publication of information or statements false in material particulars and otherwise involved negligent misrepresentations to the class of potential investors in Australia'.[474] ABN Amro was:

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[465] *ABN Amro Bank NV v Bathurst Regional Council* [2014] FCAFC 65 (Jacobson, Gilmour and Gordon JJ).
[466] These notes were sold by ABN Amro to Local Government Financial Services (LGFS) which in turn marketed these notes to 13 local government authorities in New South Wales. See *ABN Amro Bank NV v Bathurst Regional Council* [2014] FCAFC 65 [1082] (Jacobson, Gilmour and Gordon JJ).
[467] *ABN Amro Bank NV v Bathurst Regional Council* [2014] FCAFC 65 [1021] Reasons for judgment (Jacobson, Gilmour and Gordon JJ).
[468] Ibid [1022] (Jacobson, Gilmour and Gordon JJ).
[469] Ibid [1030] (Jacobson, Gilmour and Gordon) JJ.
[470] Ibid [1030] (Jacobson, Gilmour and Gordon JJ).
[471] Ibid [1030] (Jacobson, Gilmour and Gordon JJ).
[472] Ibid [1052] (Jacobson, Gilmour and Gordon JJ).
[473] Ibid [13] (Jacobson, Gilmour and Gordon JJ).
[474] Ibid [12] (Jacobson, Gilmour and Gordon JJ). Jacobson, Gilmour and Gordon JJ noted in *ABN Amro Bank NV v Bathurst Regional Council* [2014] FCAFC 65 [563]–[577] that 'S&P's rating of the Rembrandt notes was unreasonable, unjustified, and misleading (and ABN Amro knew that to be so). … For there to be a duty to exercise reasonable care in making a statement or giving advice: the speaker must realise, or ought to have realised, that the recipient of the information or advice intends to act on that information or advice … the circumstances must be such that it is reasonable in all of the circumstances for the recipient to seek, or to accept, and to rely upon the utterance of the speaker. Criteria include 'relative position of the parties as regards knowledge (actual or potential) and relevant capacity to form or exercise judgment'. Proof of these various (and not exhaustive) criteria 'establishes an assumption of responsibility, or known reliance (or the converse, vulnerability) sufficient for a duty to be imposed. It is immaterial whether the information is requested or volunteered. "It is not necessary that the person making the statement know the identity of the persons who may rely on it and suffer loss" and it can be to "an identifiable class of people"'… The complexity of the appeals proceedings by ABN Amro included the pursuit of 'each allegation of error [by the primary judge] with undiscriminating vigour'. This found no judicial favour. Ibid at [4].

knowingly concerned in S&P's contraventions of the various statutory provisions proscribing such misleading and deceptive conduct, and also itself engaged in conduct that was misleading and deceptive and published information or false in material particulars and otherwise involved negligent misrepresentations.[475]

Further,

'ABN Amro breached its contract [with LGFS]';[476] LGFS 'breache[d] its AFSL'.[477] LGFS was 'entitled to earn a substantial fee or commission on the sale of Rembrandt Notes to the Council[s]',[478] and was 'under a mandate with ABN Amro to assist in the promotion of the product'.[479]

In circumstances similar to *Wingecarribee*, claims of misleading and deceptive conduct as statutory contraventions [480] were complicated by the international operations of ABN Amro and S&P. The conduct that is misleading or deceptive must be 'in this jurisdiction'.[481] Some of the conduct was not, but the relevant conduct was the distribution of rating information in Australia with the approval of S&P. This questions the extraterritorial application of Australian law, and responses in other jurisdictions provide insight into a commonly occurring problem for Australian regulators.

4.1.2 Failures of expectations of fiduciaries in financial advice: contracting out

Unlike *Wingecarribee* and *Bathurst*, where fiduciary relationships existed, *Citigroup*[482] demonstrated it is possible in Australia to contract out of fiduciary responsibility: it can be extinguished.

> [C]laims of conflict of interest and duty and breach of s 912A(1)(aa) depended on the existence of a fiduciary relationship … the claims failed because the letter of engagement under which Toll retained Citigroup as its adviser specifically excluded the existence of such a relationship. The Court held that the law does not prevent an investment bank from contracting out of a fiduciary capacity; whether it should be able to do so is a matter for the legislature, not the courts.[483]

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[475] Ibid [12] (Jacobson, Gilmour and Gordon JJ).
[476] Ibid.
[477] Ibid.
[478] Ibid [1082] (Jacobson, Gilmour and Gordon JJ).
[479] Ibid.
[480] *Corporations Act 2001*(Cth) ss 1041E, 1041H; *Australian Securities and Investments Commission Act 2001* (Cth) s 12DA.
[481] *Corporations Act 2001*(Cth) s 1041H.
[482] *ASIC v Citigroup Global Markets Limited (ACN 113 114832)(No 4)* [2007] FCA 963 (Jacobsen J).
[483] Ibid [7] (Jacobsen J).

Claims of misleading and deceptive conduct and unconscionable conduct[484] failed for similar reasons. Thus, equitable remediation applied in *Wingecarribbee* and *Bathurst* could not be achieved.

The 'relationship between the client and the investment bank engaged to advise on a takeover is fiduciary in character',[485] but 'investment banks have developed contractual techniques to modify or displace fiduciary obligations'.[486]

> The critical matter in the end is the role that the alleged fiduciary has, or should be taken to have, in the relationship. It must so implicate that party in the other's affairs or so align him with the protection or advancement of that other's interest that foundation exists for the 'fiduciary expectation'.[487]

'Should be taken to have' is the key to the mismatch between community expectation and practice, not satisfactorily addressed by the Australian legislature or in the trust statutes. The states' *Trust(s)* and *Trustees Acts* do not prevent the exclusion of fiduciary duties. *Drake*[488] is a modern MIS example where '[f]iduciary duties are shaped, and can be modified by the trust instrument or an underlying contract'.[489]

4.2 Financial literacy

4.2.1 The problem of messianic leadership

Some investors confuse entrepreneurship with false hope. These hopes are based on trust in individuals or self-appointed Messianic figures believing their own vision. Good ideas confused with true entrepreneurship. Are these people entrepreneurs or does 'an obsessive pursuit of a sincerely held belief'[490] damage the interests of trusting investors? *Donovan*[491] was a company was controlled by such a Messiah. He had 'a lack of understanding of the proper role of a company director and the duty of diligence owed by a director to the company'.[492] Such situations are not uncommon. Despite

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[484] *Corporations Act 2001*(Cth) s 1043H; *Australian Securities and Investments Commission Act 2001* (Cth) ss 12DA, 12CA.
[485] *ASIC v Citigroup Global Markets Limited (ACN 113 114832)(No 4)* [2007] FCA 963 [265] Jacobsen J citing Tuch, above n 2.
[486] Ibid [267] (Jacobsen J).
[487] Ibid [274] (Jacobsen J) citing Finn, 'The Fiduciary Principle', above n 3.
[488] *ASIC v Drake (No 2)* [2016] FCA 155 (Edelman J).
[489] Ibid [354] (Edelman J).
[490] *ASC v Donovan* (1998) 28 ACSR 58, 609 (Cooper J).
[491] Ibid. See also ASIC, *Scams and Swindlers: investment disasters and how to avoid them: true stories from ASIC* (Centre for Professional Development, Thomson Professional Information Asia Pacific Pty Limited, 1998) 83. *Donovan* had the characteristics of a Ponzi scheme whereby new investors were constantly needed to fund obligations to existing investors. There was little end-use sales revenue and cash generated from sale of capital items were brought to revenue account.
[492] *ASC v Donovan* (1998) 28 ACSR 58, 607 (Cooper J).

written warnings from this author and others,[493] including solvency and directors duties, the directors continued to breach their obligations.

> The course of conduct embarked upon and persevered in, despite the advice given, carried a real risk of loss or damage, affecting the purchasers of growerships, the company itself, and the creditors. Objectively, no person in the position of the respondents [directors], with the knowledge the first respondent had and which the second respondent should have had, acting reasonably and exercising care and diligence, would have continued selling growerships and quotas … Absent a commercial market, to continue to sell growerships and quota was conduct in the breach of the duty of care …[494] *Corporations Law* … was a protective provision designed to protect the public and to prevent a corporate structure being used by individuals in a manner contrary to proper commercial standards.[495]

This statutory duty of care affirmed court decisions by imposing an objective standard. It inserted 'the degree of care and diligence that a reasonable person in like position as an officer of a corporation would exercise in the corporation's circumstances'.[496]

The Messiah was described thus:

> The material provided by the first respondent as to his attitude to these proceedings and the failure of Good Life is a matter of serious concern …[497] These statements indicate that the first respondent does not accept any responsibility for what has occurred …[498] The respondent has shown no contrition or remorse …[499] in disregard of contrary expert advice…[500]

4.2.2 Hope over reason: In the eye of the Storm

Effective financial advice requires financial literacy to comprehend it, including in the application of borrowed funds. *Cassimatis*[501] 'litigation was very large scale and was aggressively fought,'[502] despite Storm Financial inflicting considerable economic damage to individuals and communities in which it operated. This included an 'unprincipled submission'[503] which, if accepted,

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[493] Ibid 593 (Cooper J).
[494] *Corporations Law* s 232(4).
[495] *ASC v Donovan* (1998) 28 ACSR 58, 583 (Cooper J); *Corporations Law* s 1317EA(3)(a).
[496] *Corporate Law Reform Act 1992* (Cth) s 232(4).
[497] *ASC v Donovan* (1998) 28 ACSR 58, 603 (Cooper J).
[498] Ibid 604 (Cooper J).
[499] Ibid 608 (Cooper J).
[500] Ibid 609 (Cooper J).
[501] *ASIC v Cassimatis (No 8)* [2016] FCA 1023 (Edelman J).
[502] Ibid [838] (Edelman J).
[503] Ibid [504] (Edelman J).

> would mean that directors could act in a manner which was intended, and known, to be in serious breach of the [*Corporations Act*] yet not in breach of their duty of care and diligence for so long as they are the sole shareholders and the company is solvent. That proposition cannot be accepted.[504]

Directors cannot authorise or ratify a breach of their statutory duty[505] even if they can contract out of fiduciary law.

> Their role and responsibilities in Storm were so significant, and the contraventions were sufficiently serious … [t]hey were responsible for establishing the Storm model which provided for double gearing of thousands of clients …[506] The Cassimatis each contravened s 180(1) of the Corporations Act by exercising their powers in a way which caused or 'permitted' (by omission to prevent) inappropriate advice given to the relevant investors.[507]

Richards[508] was one Storm investor successful in a class action contested by the ASIC[509] and illustrates the practical difficulties of ex post statutory remedies.[510] 'A substantial wrong has occurred' which, at the risk of 're-enlivening an extraordinarily difficult class action'[511] requires correction.

Similarly, *Wealthsure v Selig*[512] involved unsophisticated retail investors borrowing money to finance small scale property developments by related parties. One of many cases, as in *Cassimatis*, involving retail investors investing monies into financial products on financial advice represented in disclosure documents using aggressive leverage with recourse to personal assets. Some are Ponzi Schemes, dependent on future investments to meet commitments to earlier investments.[513] Others have Ponzi characteristics reliant on hope over reason for their investment outcomes. In, *Wealthsure v Selig* amongst the portfolio of related party investments, at least one relied on a prospectus where the company was insolvent at the time of issue.[514]

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504 Ibid [506] (Edelman J).
505 *ASIC v Fortescue Metals Group Ltd* [2011] FCAFC 19 (Keane CJ).
506 *ASIC v Cassimatis (No 8)* [2016] FCA 1023 [824] (Edelman J).
507 Ibid [833] (Edelman J).
508 *ASIC v Richards* [2013] FCAFC 89 (Jacobsen, Middleton, & Gordon JJ).
509 *Richards v Macquarie Bank Limited (No 4)* [2013] FCA 438 (Jacobsen, Middleton, & Gordon JJ).
510 See especially Michael Legg, 'A Comparison of Regulatory Enforcement, Class Actions and Alternative Dispute Resolution in Compensating Financial Consumers' (2016) 38 *Sydney Law Review* 311.
511 *ASIC v Richards* [2013] FCAFC 89 [59] (Jacobsen, Middleton, & Gordon JJ).
512 *Wealthsure Pty Ltd v Selig* [2014] FCAFC 64 (Mansfield, Besanko, and White JJ); *Selig v Wealthsure Pty Ltd* [2013] FCA 348 (Mansfield, Besanko, and White JJ).
513 *Wealthsure Pty Ltd v Selig* [2014] FCAFC 64 [179] Mansfield, (Besanko, and White JJ).
514 *Selig v Wealthsure Pty Ltd* [2013] FCA 348 [1196] (Mansfield, Besanko, and White JJ).

Selling financial products to unsophisticated retail investors is fraught with risk for the promoter, financial adviser and investor. This includes loss of the investments, proportionate liability, and costs incurred by investors as a consequence.[515] Misfeasance by the investment promoters and financial advisers does not preclude an apportionable claim on the investors.[516] Investors may not have exercised due care (albeit innocently) and be partly liable for losses arising from contributory negligence. *Wealthsure v Selig* identified acts of contributory negligence included ‘profligate lifestyle and excessive living expenses, excessive borrowings, reckless statements to financiers, borrowings when aware dividends would not meet interest payments or borrowings’.[517]

4.3 Unhealthy culture

Unhealthy corporate culture recently identified by Heydon and Hayne is not a new phenomenon in Australia.

4.3.1 ‘Promiscuous lending’ in the Age of Entrepreneurship

Bell[518] reflected its times:

> ‘Promiscuous lending’, espoused in ‘the 1980’s were a period of turmoil for [the] banking in Australia as the environment changed from a highly regulated to a deregulated one which included, for the first time, competition from foreign banks from about 1985 … corporate lending boomed, fuelled by a combination of bank competition and asset inflation in asset values.[519]

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[515] *Corporations Act 2001*(Cth) pt 7.10, div 2A, ss 1041I(1B),1041L, 1041M, 1041N; *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth). French CJ Kiefel, Bell, Gageler, and Keane JJ noted in *Selig v Wealthsure Pty Ltd* [2015] HCA 18 [52] that ‘[t]hese provisions were a result of a CLERP reform designed to prevent the “deep pocket syndrome” whereby professional service providers became the targets of negligent actions as much because they are insured and have the capacity to pay large damages awards as because they are culpable whereas the primary wrongdoers were often the enterprises to whom professional services were rendered. It limits the liability of professional defendants to the extent each defendant was responsible for that loss. The objective of these reforms [in 2003] was a nationally consistent model of proportionate liability for economic loss or property damage.’

[516] *Wealthsure Pty Ltd v Selig* [2014] FCAFC 64 [11] (Mansfield, Besanko, and White JJ).

[517] Ibid [93] (Mansfield, Besanko, and White JJ).

[518] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 (Lee AJA, Drummond AJA and Carr AJA); *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No9*) [2008] WASC 239 (Owen J).

[519] Drummond AJA in *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [1812]–[1853] noted that ‘[t]he practice of bank lending on a negative pledge basis only left the banks in a much weaker position than they would have been in had they followed the traditional practice of taking security. Negative pledge lending became more prevalent in the 1980’s and gained added impetus with the emergence of the State banks as more active corporate lenders and the entry of [new] foreign bank licences in 1985 … Negative pledge lending and pricing became two of the main marketing tools used against the entrenched major [Australian] trading banks … A very dangerous and volatile situation had been created which set the time-bomb ticking and it was only a matter of time of[f] when it would explode. That time was the collapse of the ASX in October 2007. Westpac Banking Corporation lent “in excess of 25% of the bank’s capital.” The banks ‘repeatedly sacrificed prudential controls in their lending to Bell. Issuance of

Bell illustrates the devastation inflicted by unhealthy culture, collapsing with indebtedness to syndicates of 20 banks. 30 years later, the 2018 Hayne Royal Commission into the Australian financial system arises as a result of public pressure in response to alleged unhealthy cultures. The Bell banking syndicate sought to transfer company property to it 'in a situation of acknowledged insolvency'[520] leading to two decades of litigation. These were dealings between experienced people who were 'neither gullible nor unintelligent'.[521] The banks 'had not acted in good faith.[522]

This 'case cannot be characterised as involving ordinary or minor breaches of fiduciary duty.[523]

> the directors of both the Australian and UK Bell companies committed breaches of their fiduciary duties to their companies that were sufficiently serious to show that they engaged in dishonest and fraudulent designs within the special meaning I think that expression has in this context. The knowledge that the banks had of these breaches, which I consider was sufficient for the purposes of the case of these respondents based on the first limb of *Barnes v Addy*, also suffices to show the requisite knowledge on their part of the directors' designs …[524] The banks were knowing recipients of the disposition of property effected by the Transactions.[525]

They 'became "institutional constructive trustees" at the outset of the Transactions and subject to the *in personam* liabilities attached to that trust',[526] meaning responsibility to account as if they were the defaulting fiduciary.[527]

The breaches of general law fiduciary duties arose from concentrating on the interests of Bell as a whole, not its individual companies. The Australian directors should have taken into account the interests of each individual Bell company. The UK directors should have 'obtain[ed] reliable financial

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unsubordinated bonds resulted in creation of new interest bearing debt, but to retain negative pledge lending ratios, the bond securities were treated as equity with bank consent'.

[520] Ibid [4] (Lee AJA, Drummond AJA and Carr AJA).

[521] Ibid [479] (Lee AJA).

[522] Namely, knowledge of the inability of the Bell debtor companies to pay their debts to the Banks and that the execution of the [t]ransactions prejudiced all other creditors, present or future, of Bell group companies. … Bell had Australian and UK resident directors. Directors were alleged to have breached their general law fiduciary duties to act in the best interest of the companies. Ibid [587] Lee AJA; *Bankruptcy Act 1966* (Cth) s 120.

[523] *Westpac Banking Corporation v The Bell Group Ltd (in liq)(No3)* [2012] WASCA 157, [2430]–[2431] (Drummond AJA).

[524] Ibid [2432] (Drummond AJA).

[525] Ibid [1096] (Lee AJA).

[526] Ibid [1214] (Lee AJA).

[527] *Grimaldi v Chameleon Mining NL (No 2*) [2012] FCAFC 6; (2012) 200 FCR 296 (Finn, Stone, Perram JJ).

information to verify the assurances they got [from Australian directors] about the solvency'[528] of Bell.

4.3.2 Unconscionable lending to retail investors

Unconscionable lending is the cousin of promiscuous lending. *Australian Lending Centre*[529] describes broking 'loans to people who believe themselves to have difficulties in obtaining finance from traditional sources'[530] included: Mr McIlwraith (brain damaged), Mr Mrs Polimeni (production worker), Ms James (Centrelink and family benefits), Mr Mrs Alptekin (unemployed as a result of injury), and Mr Hinds (pensioner). A common element was that loans did not proceed and/or declarations were made that credit was for business purposes when palpably this was not the case.

Unconscionable or misleading conduct is proscribed in relation to financial services[531] or in connection with the supply or possible supply of financial services.[532] 'The products involved [being credit products] include those which presently exist but also those which will in the future exist'.[533] Arranging for a person to apply for, or acquire, a financial product will be 'dealing' in the financial product and … will be the provision of a financial service'.[534] Or 'a service that is otherwise supplied in relation to a financial product.'[535] This extends to requirements to pay for a contractual right[536] including prepayments made to secure a promotional offer.

Contraventions of 'credit legislation'.[537] include misleading loan applications 'representing that a person had sought a loan which was wholly or predominantly for business or investment purposes when that person had sought a loan which was for personal, household, or domestic purposes'.[538]

[528] Each company in a group is a separate legal entity; the directors of each subsidiary owe a duty to act in the best interests of their subsidiary and are not entitled to sacrifice the interests of that subsidiary for the benefit of the parent (or another member of the group. *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [2078] (Drummond AJA) citing *Charterbridge v Lloyds Bank* [1970] Ch 62; [1969] 2 All ER 1185.
[529] *ASIC v Australian Lending Centre Pty Ltd (No 3)* [2012] FCA 43 (Perram J).
[530] Ibid [1] (Perram J).
[531] *Australian Securities and Investments Commission Act 2001* (Cth) ss 12CA, 12DA.
[532] Ibid ss 12CB, 12DB.
[533] *ASIC v Australian Lending Centre Pty Ltd (No 3)* [2012] FCA 43 [176] (Perram J).
[534] *Australian Securities and Investments Commission Act 2001* (Cth) s 12BAB(8).
[535] Ibid s 12BAB(1)(g).
[536] Ibid s 12DB.
[537] Ibid; *Competition and Consumer Act 2010* (Cth), formerly *Trade Practices Act 1974* (Cth); *Consumer Credit Act 1994* (Qld); *National Consumer Credit Protection Act 2009* (Cth) s 33(2).
[538] *ASIC v Australian Lending Centre Pty Ltd (No 3)* [2012] FCA 43 [282] (Perram J).

5. THE AUSTRALIAN ENIGMA: TRUSTS AS SURROGATE COMPANIES

Australia is a global outlier in the use of trusts for commercial investment purposes. Not only are NBFE directors uncertain of the scope and extent of their fiduciary duties, these vary since MIS and superannuation entities are trusts and subject to general trust law. Statutory compliance (box-ticking) is insufficient with investor and beneficiary remedy for malfeasance often found in the general law.

5.1 MIS as commercial trusts

Collective investment schemes which predated the *Managed Investments Act*[539] did not specifically require that the management company be a trustee. The obligations of the management (and other operational companies) were contractual and entrepreneurial. By contrast, the trustee (whose role is to protect investors) was a separate entity requiring Ministerial approval. In 1987, there was 'no statutory intention to treat a management company as a fiduciary'.[540] By 2017 there was statutory trustee responsibility placed on the RE, albeit constrained by contract.[541] For collective investment schemes of the earlier generation, it is necessary to establish the existence of a trustee and beneficiary relationship between the management companies and their covenant holders.

Many of the failures in the NBFE sector result in financial stress and insolvency, especially in REs and MIS.[542] Trusts were not originally used as the large commercial trading enterprises seen today. MIS are corporatised trusts acting as surrogate companies. 'What is noteworthy is the scale of use in modern Australia,'[543] particularly since 1981. 'The nearest modern manifestation of the unincorporated joint stock company is … the managed investment scheme.'[544] Some superannuation entities are evolving into multi-country funds managers, assuming investment bank risk, and are related parties of one or more MIS.

A trust cannot become insolvent, although the trustee and RE can. The law has not evolved to deal with these modern commercial situations, although the SLE[545] proposal, not enacted, was an attempt to do so.

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539 *Managed Investments Act 1998* (Cth) Now pt 5C of the *Corporations Act* (Cth).
540 Australian Government Takeovers Panel, Companies and Securities Law Review Committee, *Prescribed Interests*, (Discussion Paper No 6, 1987) 104.
541 *Korda v Australian Executor Trustees (SA) Limited* [2015] HCA 6 [153] (French CJ, Hayne, Kiefel, Gageler, and Keane JJ).
542 Australian Government, Corporations and Markets Advisory Committee (CAMAC), *Managed Investment Schemes* (Report, 2012).
543 Nuncio D'Angelo, 'The trust as a surrogate company' (2014) 8 *Journal of Equity* 308.
544 Kevin Lindgren, 'The birth of the trading trust' (2011) 5 *Journal of Equity* 1, 13.
545 Single Legal Entity discussed in Australian Government, CAMAC, above n 542.

> It is more than passing strange that, in an advanced economy with a sophisticated legal system and a highly developed regime for regulating business enterprises conducted under an incorporated entity, the work of regulating enterprises conducted under a trust is largely left to an ancient body of law that is patently inadequate, inappropriate and inefficient for the task.[546]

Statutory prudence standards are not specified as previously and are not tests of perfection.[547] Trustee prudence standards are shaped by the nature and purpose of the trust.[548] 'Older cases … suggest[s] a duty abstracted from the terms of the trust instrument and the nature of the trust business'.[549] The modern use of trusts as investment vehicles for Australian NBFEs with substantial commercial activity mitigates against historical authorities as to preservation of capital and toward:

> more venturesome fiduciary investment policies [in the] prudent management of others' properties … [requiring] sound and careful fiduciary behaviour (including 'risk management') in carrying out programs that deliberately involve the taking of higher risk in the pursuit of greater return.[550]

The prudent person test [in the US] 'was, and is, intended to be flexible … and changes with economic conditions and contemporary thinking'.[551] As with the statutory duty of care, 'this exercise is "forward looking" to what a reasonable person would have done, and the judgment of reasonableness is not amenable to exact calculation'.[552] Changing standards require unchanging principles: these principles are necessarily fiduciary in nature.

Registered MIS are regulated by the *Corporations Act.* It imposes obligations on the trustee (RE) directors. These obligations do not extend to unregistered MIS or to collective investment schemes that are not registered MIS. 'There is a point where company law ends and trust law takes over',[553] not a distinction always recognised by directors, especially those involved in unregistered and/or insolvent MIS. 'Much of the regulation of corporatized trusts is still left to the general law of trusts'.[554] The *Corporations Act* 'leaves much of the supervision and gap-filling to the general law of trusts',[555] amply demonstrated by the cases where schemes are wound up on just and equitable grounds. 'It is

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546 D'Angelo, 'The trust as a surrogate company', above n 543, 337.
547 *ASIC v Drake (No 2)* [2016] FCA 155 [424] (Edelman J).
548 Ibid [355] (Edelman J).
549 Ibid [271] (Edelman J).
550 Ibid [270] (Edelman J) citing E C Halbach, *Restatement of the Law Third* (American Law Institute, 2007) 3 [351].
551 Ibid [265] (Edelman J) citing J D Heydon and M J Leeming, *Jacobs' Law of Trusts in Australia* (Lexis Nexus Butterworths Australia, 8th ed, 2016) 356 [17–18].
552 Ibid [354] (Edelman J) citing *New South Wales v Fahy* [2007] HCA 20 (Gleeson CJ).
553 D'Angelo, 'The trust as a surrogate company', above n 543, 306.
554 Ibid 312.
555 Ibid 324.

now commonplace for voluntary administrators, receivers and/or liquidators of companies that are trustees to seek guidance or imprimatur from the court before taking various actions for fear of committing (or permitting the company to commit) a breach of trust leading to an unindemnified personal liability'.[556]

Much of the evolution of present law is derived from judicial review:

> The law, not only statutory, but also judge-made, has, I think, moved beyond the deference once shown by courts to the judgments of company directors … even when involving judgments on matters of business management.[557]

Corporations Act provisions relating to corporate insolvency, including administration, receivership, and liquidation do not relate to trusts and MIS. Winding up provisions[558] relate only to registered MIS, not unregistered schemes, being excluded offers. Modern MIS are often leveraged with multiple layers of debt. MIS investors also are indebted with recourse to personal assets some from related parties of the RE. These related party conflicts of interest are one of the systemic causes of distress in the Australian NBFE sector unremedied by statutory intervention.

Previous law reform proposals proposed: '[t]his trust relationship should exist in all collective investment schemes, even those based on contract'[559] the intention being to create a layer of fiduciary protection for MIS members. This is the position for investors in actively managed Singaporean collective investment schemes. Most MIS, being collective investment schemes are required to adopt accounting principles and practices applying to trusts.

> A RE's powers in relation to the disposition of scheme property are determined by the terms of the scheme constitution in light of such enhancements or constraints are provided by statute and, subject to statute, the general law relating to trusts to the extent that it is applicable.[560]

In *Wellington Capital*, the constitution did not confer the power on the RE for it to act as it did. Present Australian trust law,[561] not applied in this case 'is only enlivened where the relevant beneficiary is entitled to a particular share of the trust property and notice of the intended

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[556] Ibid 334.
[557] *Westpac Banking Corporation v The Bell Group Ltd (in liq) [No3]* [2012] WASCA 157 [2027]–[2029] (Drummond AJA).
[558] *Corporations Act 2001* (Cth) pt 5C.9.
[559] Australian Law Reform Commission and Securities Advisory Committee, *Collective Investments: Other People's Money* (Report No 65, 1993) 1 [9.14].
[560] *Wellington Capital Limited v ASIC* [2014] HCA 43 (5 November 2014) [32] (French CJ, Crennan, Kiefel, Bell, and Gageler JJ).
[561] *Trusts Act 1973* (Qld) s 33(1) (1).

appropriation has been given to other beneficiaries'.[562] However, 'absent the consent of beneficiaries, it is not open to a trustee simply to transfer the trust property to the beneficiaries'.[563] This demonstrates the constraining power of the Constitution of the MIS and the *Corporations Act*. The RE has a duty to act honestly,[564] a duty of care and diligence,[565] and a duty to act in the best interests of the members of the MIS.[566] In addition to this statutory best interest duty, the RE has a statutory fiduciary duty to hold scheme property on trust for scheme members.[567] '[W]ide powers of the RE to deal with scheme property must be approached through the prism of trust law'.[568] The general principle of trust law applying to REs depends on the purposes of the statutory trust, the various provisions of the *Corporations Act*, the MIS Constitution, and is a function of its office.[569] It has the characteristics of a commercial trust,[570] analogous to public unit trusts.[571]

Can monies subscribed as MIS application monies be used to fund the liabilities of the RE of the MIS? 'The answer to the question … is no,[572] but the answer to that question is not straightforward'.[573] In *Treecorp*, two registered MIS[574] had a common RE which had agreed to act 'as trustee of the [f]unds'[575] as 'bare trustee'.[576] 'That section declares in unequivocal terms that the responsible entity of a registered managed investment scheme "holds scheme property on trust for scheme members"'.[577] Where an RE becomes insolvent, is replaced, or where the scheme property is subject

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562 *Wellington Capital Limited v ASIC* [2014] HCA 43 (5 November 2014) [18] (French CJ, Crennan, Kiefel, Bell, and Gageler JJ).
563 Ibid [32] French (CJ, Crennan, Kiefel, Bell, and Gageler JJ).
564 *Corporations Act 2001* (Cth) s 601FC (1)(a).
565 Ibid s 601FC (1)(b).
566 Ibid s 601FC (1)(c).
567 Ibid s 601FC (2).
568 *Wellington Capital Limited v ASIC* [2014] HCA 43 (5 November 2014) [12] (French CJ, Crennan, Kiefel, Bell, and Gageler JJ).
569 Ibid [12] (French CJ, Crennan, Kiefel, Bell, and Gageler JJ).
570 J H Langbein, 'The Secret Life of the Trust: the Trust as an Instrument of Commerce' (1997) 107 *Yale Law Journal* 165, 167–8.
571 Pamela F Hanrahan, 'The Responsible Entity as Trustee' in Ian Ramsay (ed), *Key developments in Corporate Law and Trusts Law: Essays in Honour of Professor Harold Ford* (LexisNexis Butterworths, 2002) 227, 231–232.
572 *Treecorp Australia Ltd (in liquidation) v Dwyer* [2009] FCA 278 [1] (Gordon J).
573 Ibid.
574 *Corporations Act 2001* (Cth) s 601EB.
575 *Treecorp Australia Ltd (in liquidation) v Dwyer* [2009] FCA 278 [6] Reasons for Judgment (Gordon J).
576 Ibid [9] Reasons for Judgment (Gordon J).
577 *Corporations Act 2001* (Cth) s 601FC(2); *Treecorp Australia Ltd (in liquidation) v Dwyer* [2009] FCA 278 [37] Reasons for Judgment (Gordon J).

to claim by way of charge or otherwise, compromises the intent of trust and statute. Statutory duties of the directors of the RE[578] are 'essentially fiduciary'.[579]

> The scope of the s 601FD duties must be considered in the light of the vulnerabilities inherent in the position of the members as beneficiaries of a trust and (as will often be the case) the fact that the RE holds itself out to the public and is paid as a professional trustee.[580]

5.2 Custodians as trustees

A custodian, often assumed to hold assets in trust for beneficiaries is subject to a lesser standard of care than an RE. There is a distinction between a managing trustee and a custodian trustee,[581] being a statutory invention.[582] 'It is apparent that the duties of a custodian trustee differ substantially from those of an ordinary trustee'.[583] A custodian trustee has 'a lesser role than an ordinary trustee'.[584] 'If the trust instrument or the general law gives the trustee power to do … it is not for the custodian trustee to consider whether it should be done'.[585] The distinction is nuanced further by the custodial trustee having responsibilities in excess of a bare trustee. The distinction is 'perhaps a fine one, but it is a real one'.[586] These distinctions are not likely to be understood by the investing public or some directors. Custodians are not always fiduciaries: they can be contractors.

> The deteriorating economic conditions revealed what should, I suspect, always have been apparent, had anyone cared to think about it: the invidious position of the Public Trustee who had legal ownership on behalf of others and wide-ranging corresponding obligations at law, but little or no control over, and not much information about, the way the funds were run. …[587] When the Public Trustee assumed legal title of property which in equity belonged to the members of the [11] managed investment schemes of which Opus was responsible entity, the Public Trustee held the property on trust for the members of the managed investment schemes as beneficiaries … notwithstanding the fact that Opus was also a trustee with different functions.[588]

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[578] *Corporations Act 2001* (Cth) s 601FD(1).
[579] *Alpha Wealth Financial Services Pty Ltd v Frankland River Olive Company Ltd* [2005] WASC 189 [33].
[580] *ASIC v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liquidation) (Controllers appointed) (No 3)* [2013] FCA 1342 (12 December 2013) [526] (Murphy J).
[581] *Re Public Trustee of Qld* [2012] QSC 281; *Public Trustee of Qld v Opus Capital Ltd* [2013] QSC 131 [20] (Dalton J).
[582] *Public Trustee of Qld v Opus Capital Ltd* [2013] QSC 131 [20] (Dalton J).
[583] *Re Brook Bond and Co Ltd's Trust Deed* [1963] 1 Ch 357, 363 cited in the matter of *Noosa Waters Pty Ltd* [1998] QSC 1 citing *Coral Vista Pty Ltd v Halkeas* [2010] QSC 449 [46].
[584] *Forster v William Deacon's Bank Limited* [1935] Ch 267.
[585] *Public Trustee of Qld v Opus Capital Ltd* [2013] QSC 131 [20] (Dalton J).
[586] *IRC v Silverts Ltd* [1951] 1 All ER 703.
[587] *Public Trustee of Qld v Opus Capital Ltd* [2013] QSC 131 [4] (Dalton J).
[588] Ibid [21] (Dalton J).

Termination of a custody agreement with a responsible entity does not change the position of the custodian trustee whilst it retains the legal title to the property of the MIS. This is problematic in Australia and particularly where there are foreign shareholders which may require shareholder approval for the variation of legal ownership.

5.3 Can economic value outcomes be legal interests?

For an investor there can be a very important difference between their legal rights and the value outcome of their investment. Investor and beneficiary expectations include the optimisation of their value outcomes, the trustee obligation. What they typically attain in MIS are contractual and statutory rights. Many MIS do not confer the beneficial economic rights that might be expected or assumed by unitholders, either in the period prior to the *Managed Investments Act* or subsequently. Contractual rights have often not extended to proprietary rights in land, buildings, plant, trees, or in some cases, products manufactured using those assets.[589] Unit holders had a contractual right to some defined proportion of the economic benefit or profit arising from the scheme. What they had in practice were one or more choses in action.[590] Even where there were security interests, this does not import the creation of a trust.[591] Prior to the *Managed Investments Act*, these rights were held by the trustee.[592] Since then, the RE or its appointed custodian.

The distinction between the economic interests held beneficially by a trustee in general law (or after 1998 an RE and its appointed custodian) and its contractual obligations is an important one. The existence of one trust can highlight the significance of the absence of any such provisions with other corporate elements in a collective investment scheme.[593] *Korda v AET* determined whether the proceeds of sale of timber produced from trees in a forestry MIS and the proceeds of sale of the land used to grow the trees were held on trust for investors in the MIS.

> The provision in the Trust Deed of an express trust only of the sale proceeds in the hands of AET… did not deflect finding that a trust existed and that 'so strong were the assurances (express and implied) in the prospectus – that the investors would have a secure interest in and entitlement to the sale

[589] *ASIC v United Tree Farmers Pty Ltd* [1997] FCA 470 (2 Jun 1997).
[590] W S Holdsworth, 'The History of the Treatment of 'Choses' in Action by the Common Law' (1920) 33, 8 *Harvard Law Review* 997.
[591] *Associated Alloys Pty Ltd v CAN 001 452 106 Pty Ltd (in liq)* [2000] HCA 25; (2000) 2020 CLR 588, 595–596.
[592] *Korda v Australian Executor Trustees (SA) Limited* [2015] HCA 6 (French CJ, Hayne, Kiefel, Gageler, and Keane JJ).
[593] Ibid [40] (French CJ, Hayne, Kiefel, Gageler, and Keane JJ).

> proceeds – that the parties to the investment contract must have intended those assurances to override any inconsistent provisions' in the formal documents.[594]

This VSCA judgment was not a unanimous view: on successful HCA appeal neither of the management companies in this collective investment scheme was held to be a trustee of the timber sale proceeds,[595] despite prospectus language designed to assuage concerns of investor risk. [P]rospective investors were:

> invited to acquire an interest in a pine plantation … using language that was simple and unambiguous, representing that an investor who purchased a covenant would acquire a beneficial interest in the land.[596]

There are many other examples of the conflict between community expectations of economic gain and legal result.[597] In *United Tree Farmers,* the promoters 'have evolved a scheme involving the invitation to investment in a venture'.[598] It had the result that

> the investors could not be said to have a right to participate in, or an interest in the assets of, the scheme. … The individual investors did not obtain any 'interest' in the scheme offered and the agreements do not create a *profit a prendre*; … all that was given was individual and discrete contractual rights of occupation … Harvesting was not part of the service offered or acquired.[599]

By inference,

> the companies propounding the scheme, despite the formal disavowal of this, were aware that this expectation was likely to be created; acted in some instances so as to positively to encourage it; and

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[594] Ibid [47] (French CJ, Hayne, Kiefel, Gageler, and Keane JJ) citing *Korda v Australian Executor Trustees (SA) Ltd* [2014] VSCA 65 [40].
[595] Ibid [96] (French CJ, Hayne, Kiefel, Gageler, and Keane JJ).
[596] Ibid [129] (French CJ, Hayne, Kiefel, Gageler, and Keane JJ). Factors in support of this judicial conclusion that the management companies were not trustees included: 'lack of separation of unit holder funds from management company funds, lack of express provision in the management contracts, the trust deed for the trusteeship of the proceeds having an express provision, and consistency with the then statutory framework regulating collective investments of this era' at [129].
[597] See, eg, *ASIC v Australian Property Custodian Holdings Ltd (Receivers and Managers appointed)(in liquidation)(Controllers appointed) (No 3)* [2013] FCA 1,342 (Murphy J); *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windso*r [1995] FCA 1663 [382] (Finn J); *ASIC v United Tree Farmers Pty Ltd* [1997] FCA 479 (Finn J); *ASIC v ABC Fund Managers Ltd (No 2)* [2001] VSC 383 (Warren J); *ASIC v Tasman Investment Management* [2006] NSWSC 943 (Austin J); *Rubicon Asset Management Limited* [2009] NSWSC 1068 (McDougall J); *ASIC v Wellington Capital Limited* [2012] FCA 1140 (Jagot J); *ASIC v Letten (No 7)* [2010] FCA 1231 (Gordon J); *Stacks Managed Investments Ltd* [2005] NSWSC 753 (White J); *ASIC v ABC Fund Managers Ltd (No 2)* [2001] VSC 383 (Warren J); *ASIC v Chase Capital Management Pty Ltd* [2001] WASC 27 (Owen J).
[598] *Australian Securities Commission v United Tree Farmers Pty Ltd* [1997] FCA 479 (Finn J).
[599] Ibid.

> on the balance of probabilities intended that it (i.e. harvesting, manufacturing and marketing of product) be created in any event.[600] [I]t extended to a right to participate in the 'profits' of the scheme.[601]

United Tree Farmers predated the *Managed Investments Act* which intended collective investment schemes be trusts and, subject to that Act, remedies be available as a constructive trust with the RE as trustee. That was palpably not the case a decade later: in *Palandri Limited,*[602] investors in six related party registered MIS had 'competing entitlements to the same vineyard'.[603] The six MIS were separated into land and property, grape growing, wine production, and distribution MIS, each with a common and conflicted RE. Each MIS had overlapping but different investors.

Wellington Capital[604] illustrates the incongruity between statutory and contractual compliance versus economic interest. The powers of an RE are determined by the constitution of the MIS operated by it and any other duty not inconsistent with the statute.[605] The MIS unit holders became members of a successor company on distribution of trust property in specie. ASIC attempted but failed to prevent this outcome, but judicial review[606] held that the RE did indeed act in breach of the Constitution. The broad power of the Constitution was constrained by specific circumstances for an in specie distribution. This ultimately resulted in a loss of the right of indemnity from trust fund assets by the RE.[607] 'The frequency and nature of the contravention cannot justify a departure from the express words of the Constitution'.[608] The RE, if it breaches the constitution loses its right to indemnity unless it 'obtains the consent of the unit holders'.[609]

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[600] Ibid.
[601] Ibid.
[602] *Re PWL ― ACN 084 252 488 LTD; Ex Parte PWL LTD (Formerly Palandri Wines Ltd) (Administrators Appointed) [No 2]* [2008] WASC 232 (Heenan J).
[603] Ibid [20]–[22] (Heenan J).
[604] *ASIC v Wellington Capital Limited* [2012] FCA 1140 (Jagot J).
[605] The RE is to apply accounting standards which apply to trusts. Constitutions vary and can include provisions which restrict the powers of the RE, and, as in this case, widen those powers. This constitution required the RE to be treated as if it were of the absolute owner of the scheme property and acting in its personal capacity. Logically, this includes the powers to distribute MIS property, even if there is a lack of detailed provision in the Constitution. Further, should the distribution be a breach of trust, this may give rise to duties, rights, and remedies, but does not of itself automatically void the transaction. See, eg, Ibid [43]–[56] (Jagot J); *Youyang Pty Ltd v Minter Ellison Morris Fletcher* (2003) HCA 15; *Corporations Act 2001*(Cth) s 124(1)(d).
[606] *ASIC v Wellington Capital Limited* [2013] FCAFC 52 (Jacobsen, Gordon & Robertson JJ).
[607] *ASIC v Wellington Capital Limited (No 2)* [2013] FCAFC 70 (Jacobsen, Gordon & Robertson JJ).
[608] Ibid [9] (Jacobsen, Gordon & Robertson JJ); *Wellington Capital Limited v Australian Securities and Investments Commission* [2014] HCA 43 [5].
[609] *ASIC v Wellington Capital Limited (No 2)* [2013] FCAFC 70 [12] (Jacobsen, Gordon & Robertson JJ).

For directors of NBFEs, these legal uncertainties, overlaid with beneficiary and investor expectations of value outcomes rather than rights, are problematic. 'There is no implied or deemed limitation of personal liability for a trustee…'[610] [under Australian trust law]. Funds management entities and their directors are fiduciaries, although some 'major investment banks have indicated publicly their belief that they operate unconstrained by fiduciary obligations'.[611] Where MIS are contractual rather than express trusts, that does not exclude the application of fiduciary principles, and a court may treat the relationship 'as fiduciary under established principles of equity.'[612] There is a tension between statutory prioritisation and fiduciary prohibitions, the result being whether an investment bank or funds manager 'is obliged by fiduciary principles to avoid positions of conflict…',[613] or not. Fiduciary relationships can be created by reasonable expectation where the client relies on the advice proferred.[614] Presently in Australia, that relationship can be avoided by contract.[615]

A purported amendment to the constitution in *Prime Trust*[616] which changed value but does not of itself change the legal rights of investors did not require investor approval, merely compliant lodgement with ASIC, its assumed validity relied upon by investors,[617] and later challenged by ASIC.[618] This uncertainty in the Prime Trust MIS documentation presented opportunities for the directors to engage in conduct compliant with the *Corporations Act*. The drafting of '[s]ection 601GC(1)(b) [*Corporations Act*] does not have "a rule-like quality" which [could] be easily identified and applied'.[619] The constitution was altered to the considerable financial benefit of the RE and ultimately its shareholders. This was particularly so for a director with manifest conflicts of interest

[610] Nuncio D'Angelo, *Commercial Trusts* (LexisNexis Butterworths Australia, 2014) 187.
[611] Tuch, above n 2, 479.
[612] Pamela F Hanrahan, *Funds Management in Australia: Officers Duties and Liabilities* (LexisNexis Butterworths, 2007) 52.
[613] Tuch, above n 2, 488.
[614] *Commonwealth Bank of Australia v Smith* [1991] 42 FCR 390 (Davies, Sheppard, and Gummow JJ); *Aequitas v AEFC* [2001] NSWSC 14 (Austin J).
[615] Tuch, above n 2, 500–502.
[616] *ASIC v Australian Property Custodian Holdings Ltd (Receivers and Managers appointed)(in liquidation)(Controllers appointed) (No 3)* [2013] FCA 1,342 (Murphy J).
[617] *Lewski v Australian Securities and Investments Commission (No 2)* [2017] FCAFC 171 [189] (Greenwood, Middleton, and Foster JJ).
[618] *Lewski v ASIC* [2016] FCAFC 96 [81], [235] (Greenwood, Middleton, and Foster JJ); *Corporations Act 2001* (Cth) s 601GC(2).
[619] *Lewski v Australian Securities and Investments Commission (No 2)* [2017] FCAFC 171 [187] (Greenwood, Middleton, and Foster JJ).

arising from related party transactions.[620] The board demonstrated an 'obvious lack of care in dealing with these important issues'.[621]

> 'Disquieted', 'alarm bells', 'well short of careful, cautious or prudent', particularly in circumstances of 'manifest conflicts of interest, lack of unequivocal legal advice, judicial direction, or members approval' [622] make an important case for law reform. '"Blind Freddy" would have recognised these conflicts…'[623]

This MIS was not managed in accordance with its unamended constitution. The directors subverted investor economic interests.

The distinction between rights and value recurs in MIS. It is not well understood by investors.[624] The test can be subjective and requires an RE to have regard to judicial opinion as well as the statute.[625] The right to have a MIS administered in accordance with its existing scheme Constitution is:

> fundamentally the most important right of membership. Without it, all other rights of membership, as well as the continuance, success, and security of the scheme would be at the whim of the RE.[626]

Meaning, judicial review results in value outcomes being rights provided that those value interests are expressed in the MIS constitution. This includes the right to have the issue price of new securities determined in accordance with an existing MIS constitution.[627] Prime Trust investors were indeed at the whim of the RE on statutory procedural grounds and through lack of value being an undefined legal interest in the constitution. However, whether value outcomes are rights for the purposes of statutory interpretation is determined on a case by case basis and leads to considerable risk for investors: all rests on disclosure in the offer documentation. 'Interest, in relation to a "financial or

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[620] *Corporations Act 2001*(Cth) ss 208, 209, pt 5C.7.
[621] Murphy J in *ASIC v Australian Property Custodian Holdings Ltd (Receivers and Managers appointed)(in liquidation)(Controllers appointed) (No 3)* [2013] FCA 1,342 [8], [186], [313] noted that '[a]dvice provided by counsel to the directors "was unusual and equivocal", proffering two potentially available interpretations of that clause of the Constitution, without guidance, being that the board did have or alternatively did not have the power to approve constitutional amendments. Further, it "advised the unqualified directors of a corporate trustee to interpret the Trust's constitution rather than providing clear legal advice as to its correct construction". It was not legal advice upon which a director could rely'.
[622] *ASIC v Australian Property Custodian Holdings Ltd (Receivers and Managers appointed) (in liquidation) (Controllers appointed) (No 3)* [2013] FCA 1,342 [317]–[321] (Murphy J).
[623] Ibid [572] (Murphy J).
[624] Confidential interview, Former MIS RE, *Unpublished report to ASIC 2015* (June 2015).
[625] *ASIC v Australian Property Custodian Holdings Ltd (Receivers and Managers appointed) (in liquidation) (Controllers appointed) (No 3)* [2013] FCA 1,342 [261] (Murphy J); *Corporations Act 2001* (Cth) s 601GC(1)(b).
[626] *360 Capital Re Ltd v Watts and Another* (2012) 91 ACSR 328 [40].
[627] *Premium Income Fund Action Group Incorporated v Wellington Capital Limited* [2011] FCA 698 [40].

business undertaking or scheme" were so general and all-embracing that it was impossible to say that it necessarily excluded particular transactions that appeared covered by the general words'.[628]

5.4 The problem of industry consolidation and vertical integration in the investment chain

Commonality of ownership business models, or vertical integration are common in NBFEs and banking. The incestuous nature of Australian NBFEs has a long history. In *AS Nominees*[629]

> [d]irectors have demonstrated little appreciation both of their own responsibilities as directors and of the trusteeship obligations of their companies … trust funds have been invested recklessly and improvidently often in cases of blatant conflicts of interest or of partiality … in one instance fraud of some magnitude has been perpetrated … shrouding much of this has been deficient and defective record keeping…[630]

AS Nominees has elements found in the later evolution of the NBFE sector. It provides insight into the systemic and cyclical problems of that sector where there is no 'general rule under which an investment manager owes fiduciary duties, or any duties, to the beneficiaries of a superannuation fund for which it provides investment management services'.[631] Duties are prescribed by contract and agency. The *SIS Act*[632] had not yet come into force and the 'legal principle will be on the law of trusts and fiduciary obligation more so than on company law'.[633] *AS Nominees* involved ten related parties,

> bound together in a predictably bewildering way'[634] in a combination of trustee (including superannuation) and non-trustee entities and required the need to view what are essentially trust law problems through the prism of corporations law.[635] Common bank accounts, boards, board meetings, absence of minutes or other documentation, and fees charged to investors by these related entities resulted in … complex breaches of trust … It has committed - and allowed - expropriation. The

[628] *Australian Softwood Forests Pty Ltd v A-G (NSW) Ex Rel Corporate Affairs Commission* [1981] HCA 49. This case referred to the statutory predecessor of managed investment schemes illustrating that a return to the prescribed interest system may not be a panacea.
[629] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windso*r [1995] FCA 1663 (Finn J).
[630] Ibid [8] (Finn J).
[631] The Law Commission (United Kingdom), *Fiduciary Law in Australia: A paper by Clayton Utz* (Consultation Paper 215, 2014) app C [8.1].
[632] *Superannuation Industry (Supervision) Act 1993* (Cth). The legislation took effect in the 1994–5 Australian financial year.
[633] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windso*r [1995] FCA 1663 [10] (Finn J).
[634] Ibid [4] (Finn J).
[635] Ibid Decision (Finn J).

> directors are accessories in this …[636] The raw material for a successful fraud claim [common law] is here and in some quantity.[637]

Misconduct recurred within *AS Nominees*:

> Imprudent investment … the boards acted in undue haste and with little deliberation. Impropriety more often than not has been associated with imprudence; an undeveloped sense of trusteeship … they have not understood the difference between the entrepreneurial action allowed companies and the caution required of trustees; conflict of interest and partiality [where directors] have not understood or felt inhibited by, their own and their companies fiduciary responsibilities; and misleading conduct.[638]

Westpoint[639] was a conglomerate of a 'large number of companies',[640] 'referred to as "mezzanine companies"'.[641] There were '193 companies, persons, trusts, or entities'.[642] Westpoint acted as trustee for a number of real property trusts and as RE for two separate MIS which invested in real property,[643] These companies:

> borrowed money from members of the public and on-lent that money to companies within the Westpoint group of companies. The mezzanine companies are beneficiaries of guarantees the company [Westpoint Corporation Pty Ltd or 'Westpoint'] for the repayment of those loans…[644]

Loans were made by retail investors in the form of promissory notes,[645] unregulated by ASIC, to entities controlled by Westpoint as both principal and agent. Corporate ownership of the companies:

> was not reflective of the manner in which the group operated. In each instance, Westpoint Corporation had control over the administrative and operational affairs of, and operated, a particular business asset as though it owned it … the affairs [of the 193 entities] were closely intertwined.[646]

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[636] Ibid [287] (Finn J).
[637] Ibid [291] (Finn J).
[638] Ibid [358] (Finn J).
[639] *ASIC v Westpoint Corporation Pty Ltd (ACN 009 395 751)* [2006] FCA 135 (Siopis J).
[640] Ibid [10] (Siopis J).
[641] Ibid [4] (Siopis J).
[642] *ASIC; In the matter of Westpoint Corporation Pty Ltd CAN 009 395 751 (Receivers and Managers Appointed) (In Liquidation) v Read* [2007] FCA 709 [3] (French J).
[643] *ASIC v Westpoint Corporation Pty Ltd (ACN 009 395 751)* [2005] WAD 395 [11] (Siopis J).
[644] Ibid [4] (Siopis J).
[645] 'I can't emphasise enough my previous written and verbal comments on the risk you run if promissory notes cannot be regarded as a pure financing transaction. Where repayment is dependent on the success of the development they are funding, this will not be the case and you will be issuing interest in a managed investment scheme, in breach of the Corporations Law — unless the scheme is registered and you wish to issue a prospectus' quoted in *Carey v Freehills* [2013] FCA 1258 [15] (Kenny J).
[646] *ASIC; In the matter of Westpoint Corporation Pty Ltd CAN 009 395 751 (Receivers and Managers Appointed) (In Liquidation) v Read* [2007] FCA 709 [10] (French J).

The company was 'hopelessly insolvent'.[647] Its collapse 'resulted in many actions'[648] requiring the analysis of '3,464 boxes of hardcopy documents … 1.8 million items of mail, 252,000 Word documents, 152,000 spreadsheets and 8,000 presentations'.[649]

Trio Capital was a conglomerate of related party entities one of which was found to have been the 'genesis'[650] of subsequent dishonest conduct. Trio was also the corporate trustee of APRA regulated public offer superannuation funds and RE of legitimate third party MIS.

'The Crown accepts, as do I, that prior to his involvement with the Trio Capital Group, he was a man of good character'[651] with 'a satisfactory history of past employment'.[652] However, subsequently from November 2005 onwards, Richard 'did not disclose to, and took steps to actively conceal from, Trio or investors … the existence of the interrelated network of companies and investment funds and his personal financial advantage from the activities of the Trio Capital Group'.[653] [He]:

> did engage in dishonest conduct in relation to financial services and knowing the conduct to be dishonest …[654]; and did make statements which were materially misleading, and known by him to be materially misleading, that were likely to induce persons in Australia to acquire financial products. ...[655] Conduct involved false representations to trustees of third party funds.[656]

Culpability extended to its auditors.[657] '[I]n the area of white collar crimes many offenders are in a like position, namely that the crime is their first offence, they are otherwise of good character…'[658]

Deterrence can:

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[647] *ASIC v Westpoint Corporation Pty Ltd (ACN 009 395 751)* [2005] WAD 395 [9] (Siopis J).
[648] *Carey v Australian Securities and Investments Commission* [2008] FCA 963 [1] (Finkelstein J).
[649] *ASIC; In the matter of Westpoint Corporation Pty Ltd CAN 009 395 751 (Receivers and Managers Appointed) (In Liquidation) v Read* [2007] FCA 709 [4]–[8] (French J).
[650] *R v Shawn Richard* [2011] NSWSC 866 [29] (Garling J).
[651] Ibid [116] (Garling J).
[652] Ibid [113] (Garling J).
[653] Garling J in ibid [41], [21]–[65] noted '[d]eceptions included international financing devices to meet redemption requests which disguised inability to meet redemptions, inflated asset valuations, misrepresentations to Trio and ASF investors, and "materially misleading statements in a Product Disclosure Statement … aware that these statements were like[ly] to induce Australians to apply for financial products, namely units in ASF". …His "conduct involved a gross breach of trust in knowingly acting contrary to the interests of corporations of which he was a director and officer which were entitled to have his complete attention, amounting to 'systemic deception'"'.
[654] *Corporations Act 2001*(Cth) s 1041G(1).
[655] Ibid s 1041E(1); *R v Shawn Richard* [2011] NSWSC 866 [21]–[23] (Garling J).
[656] *R v Shawn Richard* [2011] NSWSC 866 [53] (Garling J).
[657] Ibid [40] (Garling J).
[658] Ibid [118] (Garling J).

'[M]ark out plainly to others who might be minded to breach their professional or related obligations that such conduct will generally merit, in appropriate cases, condign punishment'.[659]

5.5 The differences between unregistered and registered MIS

Most investors are probably unaware of the differences between registered and unregistered MIS. One important difference concerns the distribution of assets of the MIS in the event of a winding up. There is no statutory scheme comparable to the winding up of a registered MIS or company.[660] '[I]f a person operates managed investment scheme … that is required to be registered unless it is registered,[661] ASIC and certain others may apply to the court to have the scheme wound up'.[662] 'The nature of the winding up process depends on what it is that is being wound up. Thus, the winding up of a trust is quite a different thing from the winding up of a company, in terms of such matters as the rights of scheme creditors and investors'.[663] The liquidator of a MIS is not the same as the liquidator of a company, although the functional objectives are similar. For unregistered MIS, there is no statutory method of winding up, as there is for a registered MIS,[664] and the court is empowered to make 'any orders that it considers appropriate for winding up the scheme'.[665] '[T]he court's general equitable jurisdiction is … a much clearer source of power…'.[666] Court winding up procedures include 'any orders it considers appropriate for the winding up of the scheme';[667] an application from the 'controller of the property of a corporation';[668] and an application from the trustee.[669]

> Where the scheme is a trust, what is envisaged by the winding up of the scheme is the realisation of its property, the payment by the responsible entity of liabilities incurred on behalf of the scheme, or the retention by it of funds with which to meet its liabilities, the ascertainment of the members' entitlements, and the distribution of the trust assets to the members in accordance with their

[659] *R v Rivkin* [2002] NSWSC 1182 (Whealy J).
[660] *ASIC v Tasman Investment Management* [2006] NSWSC 943 [16] (Austin J).
[661] *Corporations Act 2001*(Cth) s 601ED(5).
[662] *ASIC v Tasman Investment Management* [2006] NSWSC 943 [16] (Austin J); *Corporations Act 2001*(Cth) s 601EE(2).
[663] *Re Stacks Managed Investments Ltd* [2005] NSWSC 753; *ASIC v Tasman Investment Management* [2006] NSWSC 943 [16] (Austin J).
[664] *Corporations Act 2001*(Cth) s 601NF(2).
[665] *ASIC v Tasman Investment Management* [2006] NSWSC 943 [16] (Austin J); *Corporations Act 2001*(Cth) s 601EE(2).
[666] *ASIC v Commercial Nominees* [2002] NSWSC 576 [11] (Barrett J).
[667] *Corporations Act 2001* (Cth) s 601EE(1).
[668] Ibid s 424(1).
[669] *Trustee Act 1925* s 63.

> entitlements ...[670] The court cannot[671] … authorise a distribution of surplus assets of an unregistered scheme otherwise than to those entitled to the assets in proportion to their entitlements [672]

Just and equitable winding up orders also apply to registered MIS under different provisions of the *Corporations Act*,[673] to be applied in winding up including when the MIS is insolvent. Rubicon was the RE for five insolvent MIS. It was itself insolvent and could not perform its RE functions to wind up the five schemes. Thus 'the Court's powers to give directions…[674] are enlivened'.[675] These powers are considerably different to the powers accorded for unregistered MIS,[676] powers described as 'very broad and without restriction'; 'very wide and unqualified'; and 'to make "any orders" that the Court 'considers appropriate for the winding up of the scheme'.[677] The MIS constitution governs winding up of a registered MIS, with the Court having the power to give directions,[678] which can include access to RE assets diminishing their availability to other third parties.[679]

5.6 Insolvent Managed Investment Schemes

Insolvent REs are problematic: *Rubicon Asset Management.*[680] In Australia, there is no prudential supervision of MIS or their RE. Their limited capitalisation leads directly to financial inability to wind up their MIS. Solvent REs are required to use their own funds to wind up MIS for which they are RE as provided for in the MIS constitution. Insolvent REs 'should continue to perform their functions so far as they could'.[681] 'the appointment of an [RE] will not cease simply because it is under external administration'.[682] Changing an RE is not automatic, is time consuming and costly. A change only takes effect 'when ASIC's records are altered to record another company as the' [RE].[683] ASIC and MIS members may apply to the court for the appointment of a temporary RE, but the new (if temporary) RE assumes the liabilities of the former RE which may include recourse to its assets in the event of a shortfall in the assets of the MIS, subject to its constitution, and prior contractual arrangements with the former RE. Breach of fiduciary duty by the directors of the RE may result in

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670 *Re Stacks Managed Investments Ltd* [2005] NSWSC 753 [42] (White J).
671 *Corporations Act 2001*(Cth) s 601EE(2).
672 *ASIC v Tasman Investment Management* [2006] NSWSC 943 [26] (Austin J).
673 *Corporations Act 2001*(Cth) s 601NF.
674 Ibid s 601NF(2).
675 *Rubicon Asset Management Limited* [2009] NSWSC 1068 [39] (McDougall J).
676 *Corporations Act 2001*(Cth) s 601EE(2).
677 *Rubicon Asset Management Limited* [2009] NSWSC 1068 [49]–[50] (McDougall J).
678 *Corporations Act 2001*(Cth) s 601NF(2).
679 *Rubicon Asset Management Limited* [2009] NSWSC 1068 [57]–[63] (McDougall J).
680 Ibid.
681 Ibid [39] (McDougall J).
682 Ibid [9] McDougall J; *Corporations Act 2001*(Cth) s 601FH.
683 *Corporations Act 2001*(Cth) s 601FJ div 2, pt 5C.2.

a remedial constructive trust. Unless the RE holds sufficient own prudential capital[684] in trust for the MIS, or as an asset of the MIS, then recourse is to directors.[685]

5.7 Unregistered Managed Investment Schemes: caveat emptor

Australia has a long history of allowing unregistered MIS. Many occur in vertically integrated conglomerates which include superannuation funds. 'It is astounding …'[686] 'the transactions were a sham[687] to elicit a taxation advantage.[688] ABC Fund Managers[689] managed 22 trusts involved in a

> round robin of lending and investment transactions that were typically completed within a single day at the end of each financial year over a number of years ...[690] These 'daylight credit facilities' had no prospectus, no ASIC registrations as RE[691], and no records as to where the over [A]$100 million went.[692]

Misconduct in the management of the companies, misconduct in the management of the 22 trusts, and the misleading of investors resulted in winding up of the companies on just and equitable grounds.

> [T]here has been misconduct and mismanagement of the trust business to such a degree that it is inappropriate for the defendant companies to be permitted to continue to solicit, manage, and handle investors' money.[693]

Many unregistered MIS promoted in Australia have had foreign connections. In *Chase Capital Management*[694] investors in the Chase and Leadenhall Schemes were unitholders in unregistered MIS. Their foreign parents (Turks and Caicos Islands) were not registered in Australia as foreign companies. Neither were prospectus provisions adhered to and none of the entities involved held an AFSL. 'All that the word "scheme" requires is that there be some programme, or plan of action'.[695] It is not a defined term. These schemes required registration.[696] Consequently, winding up provisions

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[684] A different capital reserve to statutory NTA which is a measure of financial standing and a condition of its AFSL.
[685] *Rubicon Asset Management Limited* [2009] NSWSC 1068 [36] (McDougall J).
[686] *ASIC v ABC Fund Managers Ltd (No 2)* [2001] VSC 383 [96] (Warren J).
[687] Ibid [135] (Warren J).
[688] Ibid [125] (Warren J).
[689] Ibid.
[690] Ibid [2] (Warren J).
[691] Under the transitional rules of the *Managed Investments Act 1998* (Cth).
[692] *ASIC v ABC Fund Managers Ltd (No 2)* [2001] VSC 383 [20] (Warren J); *Corporations Act 2001* (Cth) s 286.
[693] *ASIC v ABC Fund Managers Ltd (No 2)* [2001] VSC 383 [125] (Warren J).
[694] *ASIC v Chase Capital Management Pty Ltd* [2001] WASC 27 (Owen J).
[695] Ibid [57] (Owen J).
[696] *Corporations Act 2001* (Cth) s 601ED.

have 'been enlivened'[697] on just and equitable grounds and in the public interest. Similarly, the promoter managers of the schemes were 'placed in liquidation on the grounds that it is just and equitable to do so.'[698]

Warning Bells! Had more insight applied, *Tasman Investment Management*[699] should have provoked disquiet. The thwarted triumph of equity over incomplete statute. *Tasman Investment Management* exposed dangers from related party transactions, poor documentation, and failure of fit and proper testing. Had resources been applied to fiduciary investigations it may have prevented *Trio*. Fiduciary duties of the related parties were not explored for lack of funds despite 'many facts suggestive of related party transactions and other interested self-dealings of a serious kind, prima facie justifying further investigation'.[700]

> The evidence as to whether the investors provided their money on the faith of [various documents] is very skimpy …[701] The documents provide a clouded picture of legal relationships …[702] The documents left doubt as to whether the investments by 75 investors were equity or debt and into which entity, the scheme or its RE, or a trust established for the purpose. [Ultimately], 'any intended trust was not formally constituted' …[703] There is a reasonable basis for concluding the investors retained the beneficial ownership of the funds they subscribed … [704] These funds were mixed with other funds in a common pool controlled by the recipient, one of the related party defendants, who should have received them in trust, 'to hold on terms which have not wholly divested the investors of their interest in the funds' …[705], in proportion to their contributions.[706]

Australian law 'allows each beneficiary to assert a charge over the amount remaining in the account and any assets that can be identified as having been acquired, after the mixing, by the use of funds taken from that account'.[707] So these investors held equitable charges over the monies in the account and the acquired properties, proportionately. Being an unregistered MIS, their remedy was in equity ― judicial review enforced the investor rights accordingly.

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697 *ASIC v Chase Capital Management Pty Ltd* [2001] WASC 27 [73] (Owen J).
698 *Corporations Act 2001* (Cth) s 461(1)(k).
699 *ASIC v Tasman Investment Management* [2006] NSWSC 943 (Austin J).
700 Ibid [62] (Austin J).
701 Ibid [48] (Austin J).
702 *ASIC v Tasman Investment Management Ltd* [2004] NSWSC 651 (Barrett J).
703 *ASIC v Tasman Investment Management* [2006] NSWSC 943 [53] (Austin J).
704 Ibid.
705 Ibid citing *Re Vandervell's Trusts (No 2)* [1974] Ch 269, 290.
706 *ASIC v Tasman Investment Management* [2006] NSWSC 943 [53] (Austin J) citing *Re British Red Cross Balkan Fund* [1914] 2 Ch 419.
707 Ibid [55] (Austin J).

Avestra Asset Management[708] demonstrated 'a significantly deficient corporate culture which enabled Avestra to act with a systematic and serious disregard of its fiduciary and regulatory obligations'.[709] A sole registered MIS had undisclosed related party transactions with a number of unregistered MIS and offshore investment entities. 'Generally, the conduct of Avestra was not in the best interests of scheme members, and appears to have been undertaken for the purpose of avoiding its statutory obligations and regulatory oversight'.[710]

The prohibition on registered MIS investing in unregistered MIS was removed in 2007 to allow investment diversification and international investment by MIS.[711] This statutory liberalisation facilitated related party and round robin transactions, conflicts of interest, failures in disclosure, and financial benefits by Avestra and others (eg Trio's Astarra Strategic Fund)[712] inclined to malfeasance. There is further lack of statutory clarity as to who are related parties[713] of an RE of a registered MIS and hence whether there is a financial benefit,[714] despite broad legislative intention.[715]

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[708] *ASIC v Avestra Asset Management Limited (In Liquidation)* [2017] FCA 497 (Beach J).
[709] Ibid [251] (Beach J).
[710] Ibid [11] (Beach J).
[711] *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007* (Cth) sch 1 [66] cited in *ASIC v Avestra Asset Management Limited (In Liquidation)* [2017] FCA 497 [12] (Beach J).
[712] *R v Shawn Richard* [2011] NSWSC 866 (Garling J).
[713] *Corporations Act 2001* (Cth) ss 208, 601LA(a).
[714] Ibid s 209.
[715] *ASIC v Avestra Asset Management Limited (In Liquidation)* [2017] FCA 497 [170] (Beach J).

6. CONCLUSION

There is considerably more judicial review of NBFE entities regulated under the *Corporations Act* than under the *SIS Act* or *Fair Work (Registered Organisations) Act* (as amended 2016). This is partly explained by the greatly differing number of entities regulated by each statute.

The differing approaches to regulation are influential: trust based, codified using the language of the general law *ex ante* supervision versus ex post statute based market conduct law, its effectiveness compromised and diminished by accretive statutory additions. This traverse identifies the weaknesses in Australian market conduct and supervision law. It explains how judicial interventions have sought to provide legal solutions often based in trust general law.

Australia is not unique in dealing with the problems addressed in this traverse: comparative analysis demonstrates how those comparative jurisdictions have addressed similar problems.

CHAPTER 5: INSIGHTS FROM COMPARATIVE JURISDICTIONS

The regulation of Non-Bank Financial Entities in Singapore, Germany (and European Union), United Kingdom, Canada and the United States

1. INTRODUCTION

This chapter analyses how comparable jurisdictions regulate non-bank financial entities (NBFEs), the extent and importance of fiduciary duties, related party transactions, financial advice, disclosure, financial literacy, corporate governance, director and trustee training and accreditation. The regulation of NBFEs is subject to political and economic policy objectives of individual countries. Underlying economic, strategic, and political environments influence the development of the local law. Whilst foreign statutory evolution and jurisprudence may not necessarily be easily transposed to Australia, there are important legal and regulatory developments in other jurisdictions that could and should influence Australian policy, despite variances in their NBFE regulatory architecture. The objective of this chapter is to identify and analyse insights from other jurisdictions which are applicable to the future development of Australian law.

2. STATUTORY AND REGULATORY FRAMEWORKS

2.1 Singapore

Singapore regulation of NBFEs stems from strategic policy development since 1945 and independence from Malaysia in 1965. Singapore follows Australian, English and other (British) Commonwealth practice with its own overlays. Singapore government policy is to become a world financial centre. It uses its legal framework as a strategic tool.

Capital markets regulation in Singapore is the responsibility of Monetary Authority of Singapore (MAS), Singapore Police Commercial Affairs Department (CAD), and the Approved Exchanges[1] on which securities are traded.[2] Three exchanges[3] are non-government entities but undertake market supervisory functions.

MAS is the single reserve bank, financial markets supervisor, regulator, and market conduct regulator. Its role includes the pursuit of financial stability, prudential standards, and Anti-Money Laundering and Counter-Terrorism Financing objectives. MAS controls market entry by licencing participants. Its culture is disclosure based, consultative, and business supportive including the sharing of supervisory and regulatory objectives, both prescriptive and principles based.

MAS has six oversight functions (regulation, authorisation, supervision, surveillance, enforcement, and resolution). It facilitates policy objectives in corporate governance, market discipline, and consumer education. MAS is consultative and pre-emptive, but also ex post resolver and facilitator. MAS provides for a consumer safety net,[4] but it does not: 'protect consumers from the risk that their investments will not deliver anticipated returns'.[5]

MAS' policy acknowledges that not all financial product and financial services transactions can be prescriptively policed. 'To do so would require such a high level of prescriptive detail that, even if it was possible, would be stifling to industry innovation and initiative'.[6] This highlights policy difference between compliance and industry development cultures:

[1] Monetary Authority of Singapore (MAS), *Capital Markets Enforcement* (MAS Monograph, 5 January 2016).
[2] *Securities and Futures Act* (Singapore, cap 289, 2016) s 8(1).
[3] Singapore Exchange Securities Trading Limited, Singapore Exchange Derivatives Trading Limited, and ICE Futures Singapore Pte Ltd.
[4] MAS, *Objectives and Principles of Financial Supervision in Singapore* (MAS Monograph 1, April 2004, revised September 2015) s 5 [1]–[2].
[5] Ibid s 3 [16] Objective 6.
[6] MAS, *Tenets of effective regulation* (MAS Monograph 3, June 2010 rev September 2015) s 3 [29].

> A well-regulated and supervised financial sector is not an end in itself …[7] MAS seeks to establish sound regulation of a high standard that allows well-managed risk taking and innovation, and which emphasises the stable and sustainable development of the financial services sector.[8]

MAS emphasises consistency with international standards, shared responsibility, flexibility, costs and benefits, transparency and clarity of regulation. A consistent and sound legal system means that 'institutions have certainty and predictability as to their legal obligations'.[9] This is a major theme underlying Singapore policy. A consistent and effective legal system reduces 'frequent and sudden changes that cause uncertainty and disruption to business and market practices'.[10]

> The reward of consistent regulation and a competent legal system should reduce productivity sapping ambiguities. There should be 'no question of a breakdown in the flow of information between separate parties, nor is there ambiguity about who has responsibility for what.[11]

Singapore's Single Peak model separates its statutory dual role of supervisor and industry capital markets promoter. MAS has an internal separation of supervision (MAS Banking and Insurance Group) and financial centre development, market conduct and investors (MAS Capital Markets Group), functionally similar to Australia's original Twin Peaks model.

Public policy recognises that consumer protection and punishment are compatriots. '[T]he court concluded that the objective of the disqualification regime was not punitive, but was essentially protective in nature'.[12] The primary objective of enforcement is to foster superior professional conduct and to 'achieve effective deterrence'.[13] This is achieved by periodic enforcement actions,

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[7] MAS, *Objectives and Principles of Financial Supervision in Singapore*, above n 4, s 2[5].
[8] MAS, *Tenets of effective regulation*, above n 6, Executive Summary.
[9] Ibid Tenet 6.
[10] Ibid.
[11] Andrew Campbell, 'Insolvent Banks and the Financial Sector Safety net – Lessons from the Northern Rock Crisis' (2008) 20 *Singapore Academy of Law Journal* 316, 337.
[12] Pearlie Koh, 'Punishment and Protection – The disqualification of directors in Singapore' [2013] *Singapore Journal of Legal Studies* 447, 448 citing *Ong Chow Hong* [2011] 3 SLR 1093 (HC) and *Madhavan Peter* [2012] 4 SLR 613 (HC).
[13] MAS, *Capital Markets Enforcement*, above n 1, s 1 [10].

many of them civil penalties for deceptive conduct and securities market rigging[14] fraud,[15] and insider trading.[16]

MAS supervises 'licensed banks and merchant banks, finance companies, insurance companies and brokers, capital market intermediaries, and financial advisers'.[17] NBFEs in Singapore include trustee[18] and fund management companies,[19] subject to statutory licencing regimes. Trustee companies (Singapore or foreign) are required to have at least two resident managers, each of which must hold acceptable tertiary or professional qualifications one of whom must have at least five years of relevant working experience as a component of fit and proper testing.[20] Directors of Collective Investment Schemes (CIS) fit and proper requirements mirror those for trustee companies, but there are additional relevant experience and examination criteria.[21] Fair dealing principles are explicit in organisational culture.

Fund management companies are licensed (LFMC) and hold a capital markets services licence (CMS) or registered (RFMC).[22] LFMC are distinguished by type of investor (in Australia retail or professional). RFMC is limited to the number of qualified investors (including limited liability partnership [LLP] structures) and value of assets under management limits. Licensing requirements are broad and include any person (gatekeepers) offering advice, research, portfolio influence, have non-public knowledge or access to the portfolio, named or referred to in offer documents or marketing material. The practical effect is to achieve quality assurance of the investment chain similar to the fiduciary proposals in the UK. RFMC asset under management limits (S$250 million) can be problematic as asset values grow and fund managers may require LFMC status. To some extent, the

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[14] *Chua Li Hoon Matilda v Public Prosecutor* [2009] 116 (HC); *Public Prosecutor v Lee Siew Ngan* [2010] 100 (DC); *Tan Chong Koay v Monetary Authority of Singapore* [2011] 36 (CA); *Public Prosecutor v Franco Guiseppe* [2011] 184 (DC).
[15] *Public Prosecutor v Loo Kiah Heng* [2010] 434 (DC).
[16] <http://www.mas.gov.sg/News-and-Publications/Enforcement-Actions.aspx>. See also *Public Prosecutor v Ng Chee Kheong* [1999] 204 (HC); *Lew Chee Fai Kevin v Monetary Authority of Singapore* [2012] 12 (CA).
[17] MAS, *MAS framework for impact and risk assessment of financial institutions* (MAS Monograph 2, April 2007 rev September 2015).
[18] *Trust Companies Act* (Singapore, Act 11 of 2005).
[19] *Securities and Futures Act* (Singapore, cap 289). See *Guidelines on licensing, registration, and conduct of business for fund management companies* (SFA No 04-G05 7, August 2012).
[20] *Trust Companies Act* (Singapore, Act 11 of 2005) s 74. See *Guidelines on standards of conduct for licensed trust companies* (TCA No G03, 22 December 2005).
[21] *Securities and Futures Act* (Singapore, cap 289). See *Guidelines on licensing, registration, and conduct of business for fund management companies* (SFA No 04-G05 app 1 Minimum Competency Requirements, August 2012).
[22] Ibid s 321. See *Guidelines on licensing, registration, and conduct of business for fund management companies* (SFA No 04-G05, 7 August 2012).

practical effect for RFMC licencing in Singapore echoes the 2012 SLE proposal for Australian managed investment schemes (MIS) responsible entity (RE) companies,[23] being to limit investor risk by restricting the operations of the RFMC.

Singapore NBFEs have greater barriers to entry than Australia. There must be a Singapore incorporated company with a permanent physical presence.[24] The major differences from Australia are prudential supervision, capital adequacy, fit and proper criteria, minimum funds under management[25] and an independent, non-related party custodian. Capital adequacy requires consistent minimum Base Capital[26] and Risk-based Capital.[27]

Prudential regulation includes separation of financial and non-financial businesses of banks (unlike Australia) to prevent contagion and differentiation of liquidity and prudential capital. Prudential regulation of Singapore Real Estate Investment Trusts (S-REITs) is designed to prevent undue leverage enabling these CIS to service their debt without asset liquidations. The implementation of a Code of Best Practice harmonises Singaporean CIS with international standards (including Undertakings for Collective Investments in Transferable Securities [UCITS] compliance) and Singapore listed companies. Money lending is regulated separately with reform designed to improve respectability.[28] NBFEs regulated by MAS are excluded.[29]

Superannuation in Singapore is largely government mandated and administered since 1955 by the Central Provident Fund Board (CPFB).[30] Contributions to the member accounts vary with age and other factors up to 32.5% of income. Initially a retirement scheme, it has evolved into a broad social security system including for medical expenses,[31] education,[32] life insurance,[33] family assistance,[34] housing,[35] and securities investments. To some extent the CPFB fills the role of Industry Default Funds and Workers Entitlement MIS in Australia. It differs in that the individual member can make

[23] Australian Government, Corporations and Markets Advisory Committee (CAMAC), *Managed Investment Schemes* (Report, 2012).
[24] *Securities and Futures Act* (Singapore, cap 289). See *Guidelines on licensing, registration, and conduct of business for fund management companies* (SFA No 04-G05 3.1, 7 August 2012.
[25] S$1.0 billion for retail CIS.
[26] S$1.0 million for CIS for retail investment.
[27] 120% of operational risk exposure.
[28] *Moneylenders Act* (Singapore No 31 of 2008) s 2.
[29] Sandra Annette Booysen, 'The New Moneylenders Act 2008' (2009) 21 *Singapore Academy of Law Journal* 394.
[30] *Central Provident Fund Act* (Singapore Cap 36 rev 2001).
[31] Ibid s 16 and pt VI.
[32] Ibid s 22.
[33] Ibid pt V.
[34] Ibid ss 18–19.
[35] Ibid s 15.

the investment decisions. Home ownership in Singapore is largely financed through the recycling of CPF monies into mortgages for the fund members who have one of the highest rates of home ownership in the world. It is used as an economic development tool, initially to venture finance industries, and a nascent government bond market. 'Carefully timed measures have been introduced to allow this increasingly large amount of forced savings to be productively employed to finance the nation's development'.[36]

CPFB members are allowed to borrow from their savings accounts for productive investment purposes.[37] CPFB savings are the largest single pool of investible funds in Singapore and represent some 70% of the Singapore government bond market.[38] Members may elect for the CPFB to invest their monies.[39] These trust like functions 'do[es] not fit with the traditional concept of trust law'.[40]

Singapore balances state paternalism with individual responsibility: there are limits on contributions to non-CPFB schemes. They exist primarily as corporate pension schemes and the Academic Staff Provident Board for public universities. There is some dissatisfaction with the CPF.[41] It manifests as coercion over investment policy, complexity,[42] transparency, and succession.[43] Some dissent is attributable to financial literacy failures. In practice, CPFB investments by the member are subject to CPFB approval.[44] Consequently, members are not required to remedy losses. This presents moral hazard. Will individuals make investment decisions sensibly and rationally? The tension between paternalism and cognitive ability can have severe retirement consequences:

> At the bottom of resistance to institutional assistance in decision-making is the conviction that individuals should be permitted to simply choose a course of action, no matter how inferior that course of action is for that agent.[45]

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[36] Edward Ng, 'Central Provident Fund in Singapore: A Capital Market Boost or a Drag?' in Asian Development Bank, *Rising to the Challenge in Asia: A study of Financial Markets: Volume 3 — Sound Practices* (Asian Development Bank, 2000) 55, 57.
[37] Lang Thai, 'Analysis of the Central Provident Fund in Singapore: Should Australia improve on its Superannuation Guarantee Scheme?' (2000) 3(5) *Journal of Australian Taxation* 359.
[38] Ng, above n 36, 65.
[39] *Central Provident Fund Act* (Singapore Cap 36 Revised 2001) ss 3–4.
[40] Thai, above n 37.
[41] Lim Pei Ying, Tan Shin Bin and Donald Low, 'Saving the CPF: Restoring public trust in Singapore's retirement savings system' (National University of Singapore Lee Kuan Yew School of Public Policy, 2015) 1.
[42] Thai, above n 37.
[43] Barry C Crown, 'Death and the Central Provident Fund: Legislative Intervention' (2007) *Singapore Journal of Legal Studies* 138–74.
[44] CPF Board Investment Scheme (Handbook, 1999).
[45] J D Trout, 'Paternalism and Cognitive Bias' (2005) 24 *Law and Philosophy* 393–434.

Coopers' libertarian paternalism in Australia echoes Singapore 'soft' paternalist practice: 'default rules that would enrol people automatically in savings plan … while allowing people to opt out should they decide against joining'.[46] Singapore's system is more flexible and transparent than Australia where members are not able to access their funds; those in Australian MySuper default funds have no power to determine investments, seek a trustee's reasons for decisions, or apply the funds for non-retirement purposes except in extreme circumstances.

2.2 Germany and the EU

Modern German law was given statutory form as the Basic Law[47] in 1949. Germany has a civil law system, the only two sources of law being statute (*Gesetz*) and custom (*Gewohnheitsrecht*).[48] Custom is not identical to Australian common law and 'German law does not recognise the binding force of precedent',[49] although it can be influential in certain circumstances. '[T]he judge finds the law, and does not make it.'[50] Civil law developed from Roman principles based traditions (*Corpus Juris Civilis*).[51] Historical traumas influence the German regulatory system. 'The post-war German political economy and corporate governance regime stood in sharp contrast to the neo-liberal American model.'[52] Differences included diffusion of power in corporate governance, bank shareholdings in German companies, bank financing of small- and medium-sized enterprises (*Mittelstand*), and the development of large pension funds. NBFEs did not evolve as in other jurisdictions. Libertarian paternalism was traditional German practice. Law reform in 2004 facilitated finance capitalism by transforming German governance from a stakeholder interest to a shareholder interest posture.[53]

German company law traditionally rests in statute. Non-statutory comply-or-explain doctrine regulation is recent.[54] The German Corporate Governance Code (GCGC) is voluntary and even for

[46] R Thaler and C Sunstein, *Nudge: Improving Decisions about Health, Wealth and Happiness* (Yale University Press, 2008), quoted in Ying, Bin and Low, above n 41, 12.
[47] *Grundgesetz für die Bundesrepublik Deutschland* [Basic Law of the Federal Republic of Germany] 1949.
[48] Edwin R Holmes, 'Apparent Authority and Undisclosed Principal under German Law' (1974) 4 *California World International Law Journal* 340.
[49] Ibid 341.
[50] Ibid.
[51] Udo C Braendle, 'Shareholder Protection in the USA and Germany – "Law and Finance" Revisited' (2006) 7(3) *German Law Journal* 257, 259.
[52] John W Cioffi, 'Corporate Governance Reform, Regulatory Politics, and the Foundations of Finance Capitalism in the US and Germany' (2006) 7(6) *German Law Journal* 533, 540.
[53] Ibid 560.
[54] Klaus J Hopt and Patrick C Leyens, 'Board models in Europe – Recent Developments of Internal Governance Structures in Germany, the UK, France, and Italy' (2004) 2 *European Company and Financial Law Review* 135, 140; *Aktiengesetz* (Germany) 1965 §161 [Stock Corporation Act Norton Rose trans 2009]

listed companies applies on a comply-or-explain basis,[55] designed to improve disclosure.[56] The primary statutes are the *Civil Code*[57] and the *Commercial Code*.[58] For NBFEs[59] these are supplemented by the *Stock Corporation Act,*[60] *Securities Trading Act,*[61] *Banking Supervision Act,*[62] *Investment Modernisation Act,*[63] and *Stock Exchange Act*.[64] German law has 'one unified system of law in which there was and is neither need nor room for a separate system of equity'.[65] Equitable principles are inherent in every judicial decision. Directors consequently must 'observe the spirit, as well as the letter, of German law …'[66] German doctrine reflects anglosphere fiduciary concepts but stem, other than contracted duties, from the duty of care, applied differently to Australian law. German standards of fiduciary duty and duty of care are higher 'to prevent third parties being misled …'[67]

Regulation and supervisory models for prudential, market conduct, and financial stability oversight functions vary across the EU and the European Economic Area states outside of the EU. Like Singapore, most adopt an integrated or functional model rather than three-pillar or twin peaks models.[68]

> All forms of supervision are present in all states, whether they are based on one or several supervisors … there appear to be at least fifty-four different financial supervisors in the wider European area, including Switzerland ... in Germany, although most supervision is exercised at the federal level, considerable parts of supervisory competence are still in the hands of the local state.[69]

('AktG'); Regierungskommission Deutsches Corporate Governance [Government Commission into German Corporate Governance], 26 February 2002.

55 Fenya Erzigkeit and Alina Petrescu, *The Influence of Corruption on the Corporate Governance Development in Germany* (Masters' Thesis, Karlstad Business School, 2013) 19.

56 German Corporate Governance Code (Germany) (2013) rev ed.

57 *Bürgerliches Gesetzbuch* [Civil Code] (Germany) 1907 ('BGB').

58 *Handelsgesetzbuch* [Commercial Code] (Germany) 1911 ('HGB').

59 Thomas M J Möllers, 'German Company Law and the Capital Market' (2001) 20 *Journal of Law and Commerce* 49, 51.

60 *Aktiengesetz* [Stock Corporation Act] (Germany) 1965 ('AktG').

61 *Wertpapierhandelsgesetz* [Securities Trading Act] (Germany) 1998 ('WpHG').

62 *Kreditwesengesetz* [Banking Supervision Act] (Germany) 1998 ('KWG').

63 *Investmentgesetz* [Investment Act] (Germany) 2004 ('InvG'); *Investmentsteuergesetz* [Investment Tax Act] (Germany) 2004 ('InvStG').

64 *Börsengesetz* [Stock Exchange Act] (Germany) 2002 ('BörsG').

65 Holmes, above n 49, 343.

66 Ibid.

67 Ibid 372.

68 Eddy Wymeersch, 'The structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks, and Multiple Financial Supervisors' (2007) 8 *European Business Organisation Law Review* 237, 238; See generally M Taylor, *Twin Peaks: A Regulatory Structure for the New Century* (London Centre for Financial Innovation, 1995).

69 Wymeersch, 'The structure of Financial Supervision in Europe', above n 68, 255.

State (Länder) responsibility is primarily transactional, concerning securities exchanges.[70] Multiple regulators and supervisors leads to regulatory competition, or treaty shopping, being the antithesis of harmonisation. Germany has a single integrated prudential and market conduct regulator, BaFin.[71] BaFin is not the functional equivalent of the Australian Securities and Investments Commission (ASIC). Its mandate is to 'supervise undesirable developments'[72] which 'may adversely affect the orderly conduct of trading with financial instruments or which may result in serious disadvantages for the capital market'.[73] The Bundesbank retains monetary policy independence and some oversight functions. BaFin does not apply criminal sanction, being limited to civil remedies for regulatory infringements. Criminal cases are conducted by the public prosecutor for directors' bribery[74] and corporate malfeasance cases.[75] Contracts are required to be notarised and lodged with the commercial court (*Handelsgericht*) to be legally effective.

2.2.1 Harmonisation

As in Australia:

> The 1990's witnessed the rise of large, vertically integrated financial empires. …[76] This triggered a host of regulatory responses at the domestic level, but also mobilised new efforts to improve the global governance of financial markets.[77]

[A]n efficient Single Market should have a harmonised set of core rules … greater consistency and cooperation of supervision and implementation of harmonised principles',[78] whilst maintaining the status quo in the separation of monetary policy and capital markets regulation. Harmonisation is problematic in multi-country, multi-functional, multi-legal entity related party NBFEs (eg Lehman). It poses challenges in regulation, supervision and resolution[79] without a common cross-border

[70] *Stock Exchange Act* (Germany) 2002 ('BörsG') §1(1).
[71] Bundesaufsichtsamt für Finanzdienstleistungen [Federal Financial Services Authority].
[72] *Securities Trading Act* (Germany) 1998 § 4.
[73] Rüdiger Veil, 'Enforcement of Capital Markets Law in Europe — Observations from a Civil Law Country' (2010) 11 *European Business Organisation Law Review* 409, 412.
[74] *Strafgesetzbuch* (Germany) 1998 [Criminal Code] ('StGB').
[75] *Gesetz über Ordnungswidrigkeiten* [Regulatory Offences Act] (Germany) 2013 ('OwiG').
[76] Katharina Pistor, 'Sovereign Wealth Funds, Banks and Governments in the Global Crisis: Towards a new governance of Global Finance?' (2009) 10 *European Business Organisation Law Review* 333, 343.
[77] Ibid 344.
[78] Ibid 345; See also Jacques de Larosière, *The High-Level Group on Financial Supervision in the EU* (Report, EC Brussels, 2009).
[79] Eva Hüpkes, '"Form follows function" — A New Architecture for Regulating and Resolving Global Financial Institutions' (2009) 10 *European Business Organisation Law Review* 369.

regulatory framework[80] designed for consistency in enforcement and supervision.[81] 'In many jurisdictions, the individual components of a financial group will be subject to different authorities and legal proceedings'.[82] As in Australia, political tensions influence policy:

> Harmonisation is no longer simply a functional device for removing obstacles and addressing market failures … Harmonisation is the device through which centralised [re-]regulation is imposed on the EC market-place … having transformative ambitions reflecting, inter alia, the legislature's objective to influence and indeed drive market behaviour and build and equity culture through regulation.[83]

German authorities sought to rectify these deficiencies for those 1.7% of institutions of 'systemic importance' in 2008/9.[84] Stabilisation statutes did not apply to NBFEs (being most German financial institutions).[85] Harmonisation initiatives continued requiring that the newly constituted Committee of European Securities Regulators (CESR) advice be generally binding but that national regulators including BaFin could deviate from it if they give 'full reasons for their decision'.[86] Four Framework Directives govern financial services (including credit ratings agencies), financial products, market abuse (Market Abuse Directive [EU] or MAD), prospectus issuance, misuse of financial instruments (Markets in Financial Instruments Directive [EU] or MiFID), and transparency. The Framework Directives impose sanctions, but do not provide precision.[87] The result is 'a certain complexity, albeit a uniform one'.[88] They provide limited guidance on the civil liability of securities issuers for adequate disclosure. CESR was superseded by the European Securities and Markets Authority (EMSA) in 2011. It has cross-border regulatory and supervisory powers, judicially confirmed.[89] They do not

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[80] Ibid 370.

[81] Dalvinder Singh, 'The Centralisation of European Financial Regulation and Supervision: Is there a need for a Single Enforcement Handbook?' (2015) 16 *European Business Organisation Law Review* 439, 463.

[82] Hüpkes, above n 79, 375.

[83] Niamh Moloney, *EC Securities Regulation* (Oxford University Press, 2008) cited in Pierre Schammo, 'Niamh Moloney, EC Securities Regulation (Oxford, Oxford University Press 2008) 1231 pp., ISBN 978-0-19-920274-4' (2010) 11 *European Business Organisation Law Review* (Book Review) 312.

[84] *Finanzmarktstabilisierungsgesetz* [Financial Market Stabilisation Act] (Germany) 2008 ('FmStG').

[85] Klaus J Hopt, Christof Kumpan, and Felix Steffek, 'Preventing Bank Insolvencies in the Financial Crisis: The German Financial Market Stabilisation Acts' (2009) 10 *European Business Law Review* 518.

[86] Thomas M J Möllers, 'Sources of Law in European Securities Regulation — Effective Regulation, Soft Law and Legal Taxonomy from Lamfalussy to de Larosière' (2010) 11 *European Business Organisation Law Review* 379, 380.

[87] Veil, above n 73.

[88] Möllers, 'Sources of Law in European Securities Regulation', above n 86, 383.

[89] *UK v Parliament and Council* (C-270/12) [2014] ECJ; See especially Rene Repasi, *Assessment of the Judgment of the European Court of Justice in Case 270/12, UK v Council and European Parliament: Impact of this judgment on the proposal of the SRM regulation* (Institut für deutsches und europäisches Gesellschafts-und Wirtschaftsrecht, 2014).

subsume national responsibilities other than credit reporting agencies[90] which are regulated without national intermediation.[91]

BaFin does have wide ranging principles based powers,[92] based on concepts of 'natural politeness'.[93] This regulatory model is culturally specific to Germany. It follows enlightened post-war legal concepts designed to promote a civil society, redolent of MAS' objectives in Singapore. In Australia, Hanrahan and Kingsford Smith[94] insightfully favour a similar approach over its box-ticking regulatory culture. Germany 'has realised that a lot can be gained by employing principle-based regulation'.[95] Case law is comparatively limited. Civil liability exists in tort and statute[96] for false information where proof of causality exists.

Similarity with Singapore extends to practical assessment of what is possible:

> Financial supervisors cannot be expected to reduce the probability of financial intermediaries' excessive risk taking to zero, nor can they start enforcement actions every time they are alerted about a possible compliance issue.[97]

Germany is not unique in wanting control over capital markets regulation or complexities of cross-border harmonisation. An internationally competitive economy requires regulatory competition. Supervisory effectiveness requires closeness to those entities supervised leading, as in Singapore, to a state of predictability and veracity on which all stakeholders have certainty and the ability to contribute by way of public consultation. Proximity can lead to regulatory capture, a consequence of more regulation by way of compliance leading to propensity for lobbying and capture.[98] Australian examples are reform of registered organisations and superannuation trustee governance.[99]

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[90] Carmine de Noia and Matteo Gargantini, 'Unleashing the European Securities and Markets Authority: Governance and Accountability after the ECJ Decision on the Short Selling Regulation (Case C-270/12)' (2014) 15 *European Business Organisation Law Review* 1, 29.
[91] Ibid 30.
[92] *Securities Trading Act* 1998 (Germany) ('WpHG') §§ 15(2)(2), 20a(5)(5).
[93] Veil, above n 73, 414.
[94] Dimity Kingsford Smith, 'ASIC regulation for the investor as consumer' (2011) 29 (5) *Companies and Securities Law Journal* 336; Dimity Kingsford Smith, 'A harder nut to crack? Responsive Regulation in the financial services sector' (2011) 44 (3) *University of British Columbia Law Review* 702; Pamela Hanrahan, 'ASIC and managed investments' (2011) 29 *Companies and Securities Law Journal* 297.
[95] Veil, above n 73, 417.
[96] *Securities Trading Act* (Germany) 1998 ('WpHG') § 37b.
[97] Luca Enriques and Gerard Hertig, 'Improving the governance of Financial Supervisors' (2011) 12 *European Business Organisation Law Review* 357, 375.
[98] Ibid 377.
[99] *The Fair Work (Registered Organisations Amendment) Act* 2016 (Cth) was heavily contested in Australia for some years. Industry superannuation fund governance remains unreformed.

Whilst law matters, it is problematic to assume that government regulation can drive market behaviour. In practice intertwined European and national jurisdiction mix of soft law through self-regulation, co-regulation, and government regulation, disciplined by the primacy of civil law principles and the statutory powers of minority shareholders produces results: 'Firms begin to avail themselves of corporate governance principles codes, guidelines and laws, thereby leaving the "box-ticking" phase behind'.[100] This is a salutary lesson for present Australian practice where the primacy of its *Corporations Act* results in box-ticking, facilitating creeping corruption in MIS and other NBFEs.

2.3 United Kingdom

Since 2013, financial services and financial products market conduct and prudential regulation has followed the Australian Twin Peaks model.[101] The Prudential Regulation Authority (PRA) is the equivalent of the Australian Prudential Regulation Authority (APRA). The Financial Conduct Authority (FCA) has some equivalence with ASIC. In part, this dichotomy is similar to Australia's Twin Peaks model, but it does not have an equivalent interface with the UK industrial system.

A UK distinctive feature is 'there is no statutory duty imposed on investment advisers in the UK to act in the best interest of their clients',[102] this duty being subsumed into FCA regulatory guidance with statutory support from the *Financial Services and Markets Act*.[103] Investor typology is also distinctive. Neither is there similarity between codified UK directors' duties and their Australian counterparts. Discomfort with statutory accretion in the UK has Australian echoes, leading to analysis of the proper role of fiduciary law. Despite a shared legal provenance, the UK framework is different, distinctive, and overlaid with EU regulation.

2.4 Canada

Regulation of financial services and financial products is implemented in Canada through Self-Regulatory Organisations (SRO).[104] These have statutory force governed and audited by the Canadian Securities Administrators (CSA). Other NBFEs have their own SROs: securities dealing by the

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[100] Joseph A McCahery and Erik P M Vermuelen, 'Private Equity and Hedge Fund Activism: Explaining the Differences in Regulatory Responses' (2008) 9 *European Business Organisation Law Review* 535, 537.

[101] *Financial Services Act 2012* (UK).

[102] Laura Paglia, *Standard of Conduct for Advisors and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty when Advice is provided to Retail Clients* (Canadian Securities Administrators Consultation Paper 33–403, 2013) 20.

[103] *Financial Services and Markets Act 2000* (UK) s 138D.

[104] Hazel Bateman and Geoffrey Kingston, 'Regulating Financial Advice: Lessons from the US, the UK and Canada' (2014) 4 *The Finsia Journal of Applied Finance* 7, 11.

Investment Industry Regulatory Organisation of Canada (IIROC), insurance by Managing General Agencies (MGA), and collective investments by The Mutual Fund Dealers Association of Canada (MFDA). These are also governed by the CSA. SROs derive their obligations from multiple sources including the common law.

Canada retains a federal system of securities regulation confirmed by the Canadian Supreme Court.[105] Nonetheless, cooperative federalism and precedent in trade, commerce and prudential regulatory powers, have resulted in a modicum of provincial opt-in arrangements.[106] Each province and territory 'imposes statutory duties on investment advis[e]rs,[107] and other fiduciaries.[108] Federal National Instruments, including for retail advice,[109] are administered by the CSA establishing broad principles with implementation delegated to the IIROC and MFDA. These SROs 'provide complementary, comprehensive and particularised rules, guidance and enforcement of these principles'.[110] The MFDA, being the industry SRO for collective investment schemes (in Canada, mutual funds), imposes fiduciary duties on investment managers. Business conduct rules[111] for retail investment advice are similar to Singapore and extend to '[E]ach partner, director, officer, supervisor, registered representative, investment representative, and employee...'[112]

Prudential supervision in Canada rests upon **c**ultural differences in banking regulatory policy. These are credited with efficacy of Canadian macro-prudential regulation, eliminating the need for federal interventions seen in the US and the UK. The Office of the Superintendent of Financial Institutions (OSFI) is a federal agency operating ex ante to 'work informally with regulated parties, ultimately rendering it unnecessary to take formal enforcement action',[113] and 'almost universally view[ed] to be an effective regulator'.[114] Transparency in regulation is a normative organisational objective, but the Canadian experience demonstrates otherwise in relation to regulation of its banking and superannuation experience. Other than formal regulations, 'there is no prescribed process, no

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[105] Stéphane Rousseau, 'Endgame: The impact of the Supreme Court's decision on the project to create a national securities regulator' (2011–12) 52 *Canadian Business Law Journal* 186.
[106] Jeremy Fraiberg, 'A National Securities Regulator: The Road Ahead' (2011) 52 *Canadian Business Law Journal* 174, 175.
[107] Paglia, above n 102, 30.
[108] See, eg, *Trust and Fiduciary Companies Act 2004* (PEI).
[109] *National Instrument 31-103* (Canada).
[110] Paglia, above n 102, 30.
[111] See, eg, *Business Conduct* (Investment Industry Regulatory Organisation of Canada, Rule 29) and *Business Conduct* (The Mutual Fund Dealers Association of Canada, Rule 2).
[112] Paglia, above n 102, 33.
[113] Anita Anand and Andrew Green, 'Regulating Financial Institutions: The value of Opacity' (2012) 57(3) *McGill Law Journal* 399 [4].
[114] Ibid [8].

mandated public consultation, no necessary stakeholder input or cost benefit analyses required with regard to the formulation of either policy statements or guidelines.'[115]

> OSFI's insulated and opaque structure provides certain benefits that enhance its efficacy. In particular, it is able to regulate unhampered by political lobbying, partisan politics, and majoritarian preferences. OSFI operates in a 'black box', keeping information about its policy and enforcement confidential. With its informational advantage, it is able to undermine the possibility that banks will collude or rent-seek. Our conclusions [support] regarding the value of opacity but against generally held views about the benefits of transparency in regulatory bodies.[116]

Notably, Canada applies a different definition of Twin Peaks to that in Australia. Canadian Twin Peaks refers to OSFI and the Bank of Canada. Distinctiveness in Canadian law administered by OSFI extends to prudential and other financial system regulation including some NBFEs.[117] Australia's Twin Peaks model (and the Reserve Bank) with its separation of macro- and micro-regulation is not equivalent to the Canadian model in structure or culture.

2.5 United States

Federal and State law regulates US NBFEs. US federal regulation distinguishes between broker dealers regulated by the Financial Industry Regulatory Authority (FINRA),[118] an SRO, and financial advisers regulated by the Securities Exchange Commission (SEC),[119] these categories not being mutually exclusive. '[B]oth investment advisers and broker-dealers provid[e] investment advice on both a sporadic and ongoing basis resulting in retail investor confusion.'[120] The SEC is empowered to identify 'any gaps, shortcomings, or overlaps … in the protection of retail customers'.[121] As in Australia, regulation distinguishes between retail and professional investors.

The US has been 'debating or clarifying concepts that have been developed by Canada…'[122] including statutory and common law fiduciary standards. As in Australia, this debate is politicised, dependent upon the political influence of the SEC and the appointment of its commissioners.

[115] Ibid [7].
[116] Ibid [8].
[117] See, eg, *Trust and Loan Companies Act 1991* (Canada); *Cooperative Credit Associations Act 1991* (Canada); *Insurance Companies Act 1991* (Canada); *Pension Benefits Standards Act 1985* (Canada); *Financial Consumer Agency of Canada Act 2001* (Canada).
[118] *Securities Exchange Act 1934* (US).
[119] *Investment Advisers Act of 1940* (US) 15 USC § 80b (2000).
[120] Paglia, above n 102, 7.
[121] *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* (US), USC Public Law No 111-203, § 913 (b); See especially Polina Demina, 'Broker-Dealers and Investment Advisers: A Behavioural Economics Analysis of Competing Suggestions for Reform' (2014) 113 *Michigan Law Review* 429, 432.
[122] Paglia, above n 102, 4.

Generally, the SEC relies upon contractual relationship, but the statutory and common law standards are lower than those now required in Canada 'and are otherwise abstract and unclear.'[123]

Of the US states, Delaware is influential since the majority of public companies are incorporated there. Each state in varying degrees regulate some (not all) parts of the investment chain.[124]

2.5.1 Complexity and compliance

Confusion and uncertainty extends to US superannuation funds, the majority of which in the private sector are defined contribution plans.[125] US private superannuation accounts are trusts.[126] Those persons with fiduciary status (courts exempt employer sponsors as fiduciaries when they act as settlors)[127] have prudence and disclosure obligations which extend beyond statutory requirements, reflecting trust principles.

Statutory control is primarily exercised through the *Employee Retirement Income Security Act* (ERISA).[128] 'In contrast with securities law, ERISA decentralises civil enforcement [even] amongst regulatory agencies', being the Department of Labour Employee Benefits Security Administration (EBSA), Internal Revenue Service (IRS), and Pension Benefit Guarantee Corporation (PBGC).[129] The SEC also polices fraud in US superannuation.[130]

> Unanimity among academic commentators is rare. However, on one point there does not seem to be any dissent: U.S. pension law is extraordinarily complex.[131]

Australian echoes of complicated compliance based cultures reflect the US experience of 'conflicted actors [as] plan intermediaries and service providers.'[132] At least in the US, all regulators adopt an ex ante posture.

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[123] Ibid 5.
[124] For example, Texas regulates its interpretation of fiduciaries in the Estates Code (formerly Texas Probate Code) § 751.
[125] *Internal Revenue Code 2012* (USC) § 401k.
[126] *Employee Retirement Income Security Act 1974* (USC) §§ 403, 1103.
[127] Dana M Muir, 'Decentralized Enforcement to Combat Financial Wrongdoing in Pensions: What Types of Watchdogs Are Necessary to Keep the Foxes Out of the Henhouse' (2016) 53(1) *American Business Law Journal* 33, 51. See also Dana Muir and Norman Stein, 'Two Hats, One Head, No Heart: The Anatomy of the Settlor/Fiduciary Distinction' (2015) 93 *North Carolina Law Review* 459, 493.
[128] *Employee Retirement Income Security Act 1974* (USC) Public Law No 93–406 (amended as 29 USC §§ 1001–1461 (2012)).
[129] Muir, above n 127, 48.
[130] *Securities and Exchange Act 1934* (USC) § 10(b).
[131] Muir, above n 127, 93 citing Andrew M Stumpff, 'The Law Is a Fractal: The Attempt to Anticipate Everything' (2013) 44 *Loyola University Chicago Law Journal* 649.
[132] Ibid 96.

> Agency problems abound and the trillions of dollars [c USD 23 trillion in 2016] held in pension plans are an enticing target for intermediaries and service providers who are opportunistic, desperate, or just plain greedy.[133]

As in Australia, legal uncertainty is aided by lack of harmonisation in legal definition:

> Financial wrongdoing is not a defined term in US superannuation law. Financial intermediaries are fiduciaries. ERISA expressly authorises the employer to use an 'officer, employee, agent or other representative' as a fiduciary, thereby inviting the conflicts of interest that so trouble the law of benefit denials.[134]

Decentralisation of regulation leads to disparate enforcement, including enforcement of fiduciary standards.[135] It opens the door to multiple points of political and lobbyist influence. Every organisation has a different culture. Culture determines its enforcement priorities. In the US, there is no over-riding values set between US regulators of private pensions despite their sharing 'some of the same motivations and constraints.'[136]

Corporate malfeasance more generally has been subjected to statutory intervention (*Sarbanes-Oxley Act*), particularly disclosure, governance and SEC enforcement enhancement.[137] '[A] competition among legislators to show who could be the toughest on corporate crime.'[138] Unlike Australian product disclosure statements, US financial products offer documents are required to have a comprehensive Management Discussion and Analysis chapter. This typically is more insightful than what passes for disclosure in Australia. *Sarbanes-Oxley* also requires the usage of plain English. *Taft-Hartley*[139] criminalises payments by employers to labour organisations (with certain permissible benefits), a problematic issue in Australia now rectified by the passage of the *Fair Work (Registered Organisations) Amendment Act* in 2016. Each of these standards would benefit Australian financial products consumers. Disclosures require executive certification as to factual content and to the

[133] Ibid 34.
[134] Ibid 34 citing John H Langbein 'Trust Law as Regulatory Law: The Unum/Provident Scandal and Judicial Review of Benefit Denials Under Erisa' (2007) 101 *Northwestern University Law Review* 1315.
[135] Ibid 70 citing Lauren R Roth, 'A Failure to Supervise: How the Bureaucracy and the Courts Abandoned Their Intended Roles Under ERISA' (2014) 34 *Pace Law Review* 216.
[136] Ibid 94.
[137] *Sarbanes-Oxley Act 2002* (US) Public Law No 107–204.
[138] Michael A Perino, 'American Corporate Law Reform Abroad: Sarbanes-Oxley and the Foreign Private Issuer' (2003) 4 *European Business Organisation Law Review* 213, 222.
[139] *Taft-Hartley Act 1947* (US) USC Public Law No 80–101 29 § 186(a).

processes of issuance of the disclosure.[140] Notably, whistleblower standards[141] are higher than presently apply in Australia. However, the use of 'inconsistent language has produced conflicting decisions within the federal judiciary'.[142] The SEC interpretation, allowing whistleblowers to report directly to it or through their employers, conflicts with judicial interpretation,[143] which requires direct SEC reporting.[144]

2.5.2 Limitations of statutes: criminogenic organisations

These statutory interventions have not prevented '[t]he Rise of Criminogenic Organisations'.[145] *Sarbanes-Oxley* compliance and enforcement standards, like the Australian *Corporations Act* does not change the values and ethics of organisations. It merely encourages box ticking by those with executive responsibility for disclosure. US scholarly research mirrors Hanrahan and Kingsford Smith in Australia demonstrating the difference between compliance based cultures and values based cultures and how 'assumptions of rationality in economic theory are contradicted by experimental evidence'.[146]

This is important behavioural economics research with global multi-cultural implications[147] now finding its way into Canadian regulation of financial products and services, but receiving only limited scholarly attention in Australia. It provides the theoretical basis for the imposition and extension of fiduciary principles to those sectors being one solution to the manifest conflicts of interest that occur in financial products and services. In the US, after *Sarbanes-Oxley,* there was:

> an outbreak of high-level, large-scale white-collar crime. Each illegal act was no doubt surrounded by a broad penumbra of unethical conduct, yet in each case the core actions all involved a failure to respect the law.[148]

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[140] *Sarbanes-Oxley Act 2002* (US) Public Law No 107–204 § 302.
[141] *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* (US), USC Public Law No 111–203 § 922.
[142] Samuel C Leifer, 'Protecting Whistleblower Protections in the Dodd-Frank Act' (2014–15) 113 *Michigan Law Review* 121.
[143] *Asadi v G E Energy (USA) LLC* 720 F 3d 620 (5th Cir 2013).
[144] Andrew Walker 'Why shouldn't we protect internal whistleblowers? Exploring justification for the Asadi decision' (2015) 90 *New York University Law Review* 1761.
[145] Don Mayer, Anita Cava, and Catharyn Baird, 'Crime and Punishment (or the Lack Thereof) for Financial Fraud in the Subprime Mortgage Meltdown: Reasons and Remedies for Legal and Ethical Lapses' (2014) 51(3) *American Business Law Journal* 515, 529.
[146] Ibid 534 citing Dan Ariely, *Predictably Irrational: The Hidden Forces That Shape Our Decisions* (Harper Perennial, 2010).
[147] Ibid 541.
[148] Ibid 538 citing Joseph Heath, 'Business Ethics and Moral Motivation: A Criminological Perspective (2008) 83 *Journal of Business Ethics* 595.

These failures in ethics and the cultural values that engender criminogenic organisations are systemic in the US and have global impact. Credit rating agencies (CRA) are fundamental to the NBFE (and banking) system worldwide. Their actions have resulted in very large investor losses globally and in multi-jurisdictional litigation, including Australia,[149] Germany,[150] Austria,[151] and the US.[152] Many of these losses can be attributed to rated structured finance products sold to retail, professional and institutional investors. These rated products included Credit Default Swaps (CDS). CDS are a form of insurance where the issuer of the CDS assumes credit risk. They have not been prudentially regulated.[153] Prima facie, as important gatekeepers, CRAs should be subject to liability.

> Failures of credit rating agencies were essential cogs in the wheel of financial destruction. Without the high ratings issued by credit rating agencies, the mortgage-related securities at the heart of the crisis could not have been marketed and sold in such vast numbers.[154]

The *Dodd-Frank Act*[155] provides for administrative monitoring through the Office of Credit Rating.[156] However,

> empirical evidence suggests that, if pre-crisis, '[t]he story of the credit rating agencies is a story of colossal failure' due to systemic misreporting of creditworthiness by CRA's and the *Dodd-Frank Act* has only made matters worse by further reducing ratings informative content.[157]

This suggests failures in disclosure facilitated by compromised statute and failures in the value system of these gatekeepers. '[C]orporate governance in CRA's needs to be viewed as a problem, rather than

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149 See especially *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 (Rares J); *ABN Amro Bank NV v Bathurst Regional Council* [2014] FCAFC 65 (Jacobson, Gilmour and Gordon JJ).
150 Luigi Guiso, 'Trust and Risk Aversion in the Aftermath of the Great Recession' (2012) 13 *European Business Organisation Law Journal* 195, 209.
151 Susanne Kalss, 'Civil Law Protection of Investors in Austria — A Situation Report from Amidst a Wave of Investor Law Suits' (2012) 13 *European Business Organisation Law Review* 211, 212.
152 *California Public Employees' Retirement System v Moody's Investor Services, Inc* case number A134912 (Cal Ct App, 2014).
153 Benjamin B Saunders, 'Should Credit Default Swap Issuers be subject to prudential regulation?' (2010) 10(2) *Journal of Corporate Law Studies* 427.
154 Symposium, 'American University Business Law Review Symposium: Law, Finance and Legitimacy after Financial Reform' (2011) 1 *American University Business Law Review* 1 citing Brooksley Born, 'Financial Reform and the Causes of the Financial Crisis' (2011) 1(1) *American University Business Law Review* 1, 5.
155 *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* (US), USC Public Law No 111–203 § 939C.
156 Alessio M Pacces and Alessandro Romano, 'A Strict Liability Regime for Rating Agencies' (2015) 52(4) *American Business Law Journal* 673, 675.
157 Ibid 676–7 citing Valentin Dimitrov et al, 'Impact of the Dodd–Frank Act on Credit Ratings' (2015) 115 *Journal of Financial Economics* 505.

as a solution'.[158] The European Financial Stability Board (EUFSB) goes well beyond US practice: introducing duties of skill and care and fiduciary duties of fund managers:

> Fund managers purchasing securities must be able to demonstrate that they understand both the security and the underlying assets. The law could provide that simply relying on an investment-grade rating will not suffice to discharge the fiduciary obligation of prudence. This would reduce demand for complex products that virtually no one understands, making them virtually unsaleable and therefore reducing the incentives of investment banks to develop them.[159]

The US has not followed this course. That regulators should need to suggest fund managers actually comprehend the securities purchased for their clients speaks loudly of the gap between community expectations and market practices. It also supports the need for reform of the underlying principles in regulation. Statutory compliance achieves lesser outcomes than fiduciary responsibility.

There is 'no simple fix'.[160] Independent, non-partisan ex ante supervision within an institutional framework which eliminates too big to fail moral suasion arguments is a starting point. The US (banks) has followed the opposite statutory course,[161] although there are more recent, un-enacted, calls for a return to the status quo ante[162] which separated commercial and investment banking systemic risks. Previous statutory reform[163] designed to reduce systemic risk in the financial system (bank and NBFE) including diminishing proprietary trading and their conflicts of interest (the Volcker Rule)[164] has not reduced 'market failure that endangers the economy'.[165] Rather than prohibition, political compromise resulted in a statutory limitation of 3.0% of bank tier 1 capital to be applied to proprietary trading.

The 'enormous complexity'[166] of the *Dodd-Franks Act* has echoes in Australia's *Corporations Act* in two other respects. First:

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[158] Andrew Johnston, 'Corporate Governance is the problem, not the solution: a critical appraisal of the European Regulation on Credit Rating Agencies' (2011) 11(2) *Journal of Corporate Law Studies* 395, 438.
[159] Ibid.
[160] Mayer, Cava and Baird, above n 145, 597.
[161] *Gramm-Leach-Bliley Financial Modernisation Act 1999* (US) Public Law No 106–102.
[162] *Glass-Steagall Act 1933* (US).
[163] *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* (US), USC Public Law No 111–203.
[164] Ibid §§ 619–621.
[165] CCH Attorney-Editor and Staff, 'Dodd-Frank Wall Street Reform and Consumer Protection Act Law, Explanation and Analysis' (2012) 13 *European Business Organisation Law Review* 303.
[166] Ibid 298.

> The Act continues to rely on the old regulatory principles and assumptions despite the dramatic change in the financial sectors since that era [1930s New Deal]. The regulatory philosophy of the Act is still focussed on form rather than function.[167]

Second:

> The application of the Volcker rule will depend on how the regulators interpret it since the concept of proprietary trading is vague and imprecise. After all, the basic expectation of the rule of law is that the rules are clear and intelligible and important issues should not be left to the whim of the legislators.[168]

The *Dodd-Frank Act* resembled the Australian Corporate Law Economic Reform Program process, being a 'matrix of 243 legislative amendments, additions and broad prescriptions for corresponding rules to be promulgated over a 24 month period.'[169] *Sarbanes-Oxley* and *Dodd-Frank* attempted to rectify the manifestation of systemic problems with statute. However, '[t]here is now a concerted effort by some large financial institutions and their trade associations to prevent full implementation and enforcement.'[170] This effort manifests in proposed reform to *Sarbanes-Oxley* and *Dodd-Frank*[171] the outcome of which is uncertain, but intended to repeal the Volcker Rule and reform the SEC under the guise of capital markets deregulation to promote 'hope and opportunity'.[172] The fractured nature of the US statutory framework and its enforcement still provides for firms to '[s]elect amongst supervisors, leading to a regulatory race to the bottom'.[173] 'The literature on comparative financial supervision and enforcement places the US as both a global leader and a global outlier'.[174]

Unlike Canada and Australia, SEC commissioners are blatantly political appointments. A strength of the Canadian system is the separation of direct political influence from regulation. It is not clear that Australia has this separation. This author's qualitative research suggests otherwise, although heavily nuanced compared with the overt politicisation of the SEC. Inference also suggests that some superannuation trustee capital allocations do not meet the statutory sole purpose test. These

[167] Ibid 301.
[168] Ibid 300.
[169] Philip Jamieson, 'Dodd–Frank and ABS: From Reaction to Reform — The Investor Protection and Securities Reform Act, 2010' 22 *Journal of Banking and Finance Law and Practice* 173.
[170] Symposium, above n 154, citing Born, above n 154, 6.
[171] *Financial Choice Act of 2017* (US) 10 HR.
[172] Ibid.
[173] Symposium, above n 154, citing Born, above n 154, 3.
[174] John Armour, Martin Bengtzen and Luca Enriques, *Investor Choice in Global Securities Markets* (New Special Study of the Securities Markets, Columbia Law School/Columbia Business School Program on the Law and Economics of Capital Markets, March 2017) [8.1].

allocations include related party investments, sponsorships, advertising, and social policy purposes.[175] As in the US, protection arising from related party political campaign contributions and regulatory capture in a contested statutory environment can make enforcement problematic.[176]

[175] Judith Sloan, 'We can't trust the trustees of industry super funds', *The Weekend Australian* (Sydney), 26 November 2016, 22.
[176] Mayer, Cava and Baird, above n 145, 571.

3. FIDUCIARY AND CIVIL LAW FRAMEWORKS

3.1 Singapore

3.1.1 Fiduciary and Non-Fiduciary Duties of Fiduciaries

Traditionally, Singapore follows a strict proscriptive fiduciary tradition with courts not wishing to 'second guess'[177] the actions of directors.[178] Usually, 'the fiduciary will owe the principal non-fiduciary duties, which do not affect and are not affected by the fiduciary duties owed'.[179] As in other jurisdictions, the non-fiduciary duties will depend on factual context. Legal responsibility will depend on the cause and may include breaches of fiduciary and non-fiduciary duties.[180] Disclosure problems of Singaporean directors arise from statutory ability to: 'sanction transactions involving interested directors where those directors abstained from voting'.[181]

The disclosure principle: 'removes the proscription so that no [fiduciary] breach ever arises in the first place',[182] being a narrow interpretation of fiduciary duty. More recently, enhanced standards of care required of Singapore company directors result in objective criteria including: 'non-delegable duty of supervision',[183] following English[184] and Australian cases.[185] However: 'Whilst our company law mirrors that in England in many aspects, there nevertheless remain sufficient differences to warrant careful and contextual application'.[186]

3.1.2 Duty of care

Singapore, like Australia now has 'three general duties of care …' resulting in '… a relatively simple matter [becoming] gratuitously complex.'[187] In Singapore, the: 'interests of the company is not just profit maximisation. Neither is it profit maximisation by any means'.[188]

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[177] *ECRC Land Pte Ltd v Ho Wing On Christopher* [2004] 1 SLR 105.
[178] Hans Tjio, 'The rationalisation of directors' duties in Singapore' (2005) 17 *Singapore Academy of Law Journal* 52, 54.
[179] Vicki Vann, 'Causation and breach of fiduciary duty' (2006) *Singapore Journal of Legal Studies* 86, 107.
[180] Rebecca Lee, 'Causation and account of profits for breach of fiduciary duty' (2006) *Singapore Journal of Legal Studies* 488, 503.
[181] *Dayco Products v Ong Cheng Aik* [2004] 4 SLR 318 [14] (Belinda Ang Saw Ean J).
[182] Tjio, 'The rationalisation of directors' duties in Singapore', above n 178, 61.
[183] Ibid citing *Vita Health Laboratories Pte Ltd v Pang Seng Meng* [2004] 4 SLR 162.
[184] *Re Barings plc (No 5)* [2000] 1 BCLC 523 [36] (Morritt LJ).
[185] *Daniels v Anderson* (1995) 16 ACSR 667.
[186] Pearlie Koh, 'Disclosing conflicts of interest' (2005) 17 *Singapore Academy of Law Journal* 465, 475 citing *Dayco Products Singapore Pte Ltd v Ong Cheng Aik* [2004] 4 SLR 318 (Belinda Ang Saw Ean J).
[187] John H Farrar, 'Directors duties of care – Issues of Classification, Solvency, and Business Judgment and the Dangers of Legal Transplants' (2011) 23 *Singapore Academy of Law Journal* 745, 760.
[188] *Ho Kang Pang v Scintronix Corp Ltd* [2014] 3 SLR 329 (Chao Hick Tin JA).

> Value, increasingly in the corporate world cannot be just about pecuniary outcomes … to nurture and sustain corporate value, the roles of values and norms are surprisingly under-estimated,[189]

requiring an evolution beyond statutory compliance outcomes to values based on fiduciary and equitable principles. Fiduciary duties can extend to the best interest of the company and the exercise of that power for a proper purpose.[190] Nonetheless,

> The duty to act for proper purposes is seldom applied and this not well developed in Singapore … a dearth of authority in Singapore applying the duty to act for proper purposes.'[191] 'The duty to act bona fide in the interests of the company – appears to be applied more frequently in the Singapore courts.[192]

Complexity extends to a directors' duty of care and: 'how [a] duty of care can be found to exist between defendants and claimants who do not have contractual or other legal connection'.[193] The Singapore duty of care test, and negligence claims arising from its breach, relies heavily on the presence of proximity. '[P]roximity has substance that is capable of being defined and capable of being expressed in terms of legal principles',[194] proximity being 'simply another concept co-equal in operation to assumption of responsibility and reasonable reliance.'[195]

In Singapore, 'The duties of care of directors developed in equity, statute, and common law'.[196] Statutory intervention in Singapore[197] carries criminal penalties and is not a reformulation of equitable or common law provisions.[198] Equitable duty of care may be fiduciary with, 'consequences for causation, remoteness [proximity], limitation and proprietary remedies'.[199] These consequences are ill-determined in equity, may result in director tortfeasance, but do carry statutory criminal penalty. These 'concentrate the mind'[200] but lead to tensions between crime control as a strategy in economic

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[189] Eugene K B Tan, 'Corporate social responsibility as corporate soft law: mainstreaming ethical and responsible conduct in corporate governance' (2013) 31 *Singapore Law Review* 227, 240.
[190] *DM Divers Technics Pte Ltd v Tee Chin Hock* [2004] 4 SLR 424.
[191] Lee Suite Lin Joyce, 'Making a case for the duty to act for proper purposes' [2014] *Singapore Journal of Legal Studies* 79.
[192] Ibid 95.
[193] A L R Joseph, 'Establishing a duty of care: Singapore's single, two stage test' (2008) 20 *Singapore Academy of Law Journal* 251, 253.
[194] *Spandeck Engineering (S) Pte Ltd v Defence Science & Technology Agency* [2007] 4 SLR 100 [80] (Chan CJ).
[195] Joseph, above n 193, 268.
[196] Farrar, 'Directors duties of care', above n 187.
[197] *Companies Act* (Singapore Cap 50, 2006 [rev ed]) s 157.
[198] Farrar, 'Directors duties of care', above n 187, 746.
[199] Ibid 750.
[200] Timothy Liau, 'Is criminalising directorial negligence a good idea?' (2014) 14(1) *Journal of Corporate Legal Studies* 175, 205.

development and Singapore's version of liberal capitalism. Director's duties 'should transit to a civil penalty regime …'[201] already extant in securities regulation.

3.1.3 Business Judgment Doctrine

There is a recurring theme between 'the importance of judicial restraint in order to facilitate entrepreneurship[202]… [and the] ordinary norms of commercial morality … [which] must be observed'.[203] This is reflected in the difference between business judgment doctrine (as a policy) and a statutory business judgment rule. Statutory restraint in business judgment and reliance upon general law norms distinguishes Singapore from other jurisdictions where there are statutory business judgment rules of varying efficacy. Singapore has not codified business judgment' relying on common law and equitable principles requiring due care. It does follow business judgment doctrine for economic competitiveness, but without a statutory rule governing judicial review: 'broad economic policy, built upon economic freedom and the encouragement of informed risk taking'.[204] The missing statutory rule is the legal implementation of the doctrine. If implemented, Singapore, in its international harmonisation objectives, should look to the US Delaware or ALI formulations, the latter theoretically reflected in the Australian jurisdiction,[205] its compromised statute emasculated judicially.

3.1.4 Best interest

Singapore law on insider trading has evolved from its fiduciary traditions,[206] following Malaysian law,[207] itself following Australia and Ghana.[208] Statutory intervention[209] relies on notions of 'information parity'[210] and supplants fiduciary traditions themselves reliant on 'information connectedness'.[211] Given Singapore's penchant for the licensing of all elements of the financial

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[201] Ibid 176.
[202] Tjio, 'The rationalisation of directors' duties in Singapore', above n 178, 64.
[203] *Vita Health Laboratories Pte Ltd v Pang Seng Meng* [2004] 4 SLR 162 [18].
[204] Douglas M Branson, 'A business judgment rule for incorporating jurisdictions in Asia' (2011) 23 *Singapore Academy of Law Journal* 687, 689.
[205] Ibid 709; see also American Law Institute Principles of Corporate Governance and Structure § 4.01(c); cf *Corporations Act 2001* (Cth) s 180(2).
[206] Alexander F Loke, 'From the Fiduciary Theory to Information Abuse: The Changing Fabric of Insider Trading Law in the UK, Australia, and Singapore' (2006) 54 *American Journal of Comparative Law* 123; see *Percival v Wright* [1902] 2 Ch 421.
[207] *Companies Act 1965* (Malaysia).
[208] L C B Gower, *Companies Code 1963* (Ghana). See especially Kofi Date-Bah, 'Revitalising Gower's Legacy: Reforming Company Law in Ghana' (2011) 29(3) *Penn State International Law Review* 449. See also Ernest Owusu-Dapaa, 'Reforming the Company Codes of Ghana: Which Way to Go?' (2007) 33(2) *Commonwealth Law Bulletin* 209.
[209] *Securities and Futures Act 2001* (Singapore).
[210] Loke, 'From the Fiduciary Theory to Information Abuse', above n 206, 154.
[211] Ibid 152.

services and products infrastructure (the gatekeepers), what constitutes information which cannot be used for private purposes is broad. It extends to chance findings as well as information gatherers. All elements of the investment chain need to ensure broad disclosure prior to any private use of information.[212] Particular caution is required in cases of Chinese Walls.[213] Statutory intervention[214] eliminated previous law requiring intention to use the information.[215]

As in Australia, defining best interest has been problematic with a 'large number of oppression actions'.[216] These are often in family companies with different corporate governance arrangements from entities organised on agency principles, some of which are now structured as statutory business trusts. Family companies are often run more informally than listed public companies. Nonetheless, informal disclosure is 'unsustainable in law'.[217]

3.2 Germany and the EU

3.2.1 Civil law in Germany: the equity-like counterweight

A separate legal principle, (equitable as it would be interpreted in Australian law): *untreue*,[218] literally disloyalty or unfaithfulness, governs intent. This doctrine has both subjective (*Guter Glaube*) and objective (*Treu und Glauben*) elements. 'Subjective good faith typically designates a state of mind … [o]bjective good faith identifies a specific standard of conduct …'[219] These duties have proscriptive and prescriptive elements:

> The proscriptive dimension partially coincides with the scope of [UK] fiduciary duties … [t]he prescriptive dimension engenders onuses different and ulterior to those previously imposed by performance obligations at common law and this imports an even more pronounced recast of the legal sphere of agents.[220]

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[212] *Securities and Futures Act 2001* (Singapore) s 219.
[213] Loke, 'From the Fiduciary Theory to Information Abuse', above n 206, 169–70.
[214] *Securities and Futures Act 2001* (Singapore) s 220.
[215] *Public Prosecutor v Ng Chee Kheong* [1999] 204 (HC).
[216] Tjio, 'The rationalisation of directors' duties in Singapore', above n 178.
[217] Koh, 'Disclosing conflicts of interest', above n 186, 468; citing *Dayco Products v Ong Cheng Aik* [2004] 4 SLR 318 [18] (Belinda Ang Saw Ean J).
[218] Luca Enriques, 'Related Party Transactions: Policy Options and Real-World Challenges (with a Critique of the European Commission Proposal)' (2015) 16 *European Business Organisation Law Review* 1, 24.
[219] Andrea Tosato, 'Commercial Agency and the Duty to Act in Good Faith' (2016) 36(3) *Oxford Journal of Legal Studies* 661.
[220] Ibid 695.

Untreue duties extend to third parties, being 'a specific obligation to take care of third parties' pecuniary interests'.[221] Exposure to ex post judicial review under this doctrine results in Germany being the 'closest to a pure liability model among the main jurisdictions …'[222] and can have criminal consequences.[223] Liability can be limited under business judgment rules, but only if a decision was based on adequate information which 'requires both a thorough search for information and its sufficient control'.[224] Reliance on third party information is not sufficient.[225] Recklessness, acting in bad faith, is a breach of the *untreue* duty with statutory consequences.[226]

The cogency of German civil doctrine has 'progressively permeated the private law sphere of the EU legal order, appearing with increasing frequency in legislation, jurisprudence and soft law'.[227] There is considerable German legal history of statutory protection of the economic interests of minority shareholders in related or controlled entities (*Konzernrecht*). This is emulated in EU law.[228]

Germany enforces ex post prohibitions on directors and controlling shareholders duty of loyalty with ex post compensation of individually harmful transactions, the penalty being exposure for criminal breaches of trust.[229] BaFin and the courts may interpret case facts differently, with different penalties. It can result in the statutory provision for loss of shareholder rights, unknown in Australian or English law. This loss of rights, including ownership, dividend, and voting 'occurs by act of law'.[230] A court can order the divestiture of property and rights separately from criminal liability pursuant to the *untreue* fairness principle. Individual and minority shareholders are able to seek divestiture. '[T]he forfeiture of rights is a draconian enforcement measure as it renders any investment futile'.[231]

[221] Volker Krey, 'Financial Crisis and German Criminal Law: Managers' Responsibility for Highly-Speculative Trading in Obscure Asset-Backed Securities Based on American Subprime Mortgages' (2010) 11(3) *German Law Journal* 319, 326.
[222] Enriques, above n 218, 24.
[223] Krey, above n 221, 324.
[224] Ibid 326.
[225] Ibid 327.
[226] *Stock Corporation Act* (Germany) ('AktG') §§ 93(1).
[227] Tosato, above n 219; *Council Directive 86/653/EEC of 18 December 1986 on the coordination of laws of the Member States relating to self-employed commercial agents* [1986] OJ L 382, 31/12/1986 P 0017–0021.
[228] Thomas W Wälde, 'Parent-Subsidiary relations in the integrated corporate system: a comparison of American and German law' (1974) 9 *Journal International Law and Economics* 455, 492.
[229] Enriques, above n 218, 24.
[230] *Securities Trading Act* (Germany) 1998 ('WpHG') § 22; Veil, above n 73, 419.
[231] Dirk Zetzsche, 'Hidden Ownership in Europe: BaFin's Decision in Schaeffler v Continental' (2009) 10 *European Business Organisation Review* 115, 143.

Additional contract law fiduciary protection, *culpa in contrahendo,* has a statutory 'very detailed level of codification'.[232]

> The provided information is meant to enable the client to make a self-dependent investment decision. The duties of the investment firm are not only confined to the provision of information though. In fact the investment firm has to investigate whether the specific financial instrument or the investment service fits the respective client.[233]
>
> The investors do in fact not consume the information, but only the confidence,[234] [leading to] dependence and … the deliberate influence exercised by the issuer on the investor … is a legal relationship and a violation of same out of *culpa in contrahendo* …[235]

So, German law differs substantively from Australian law. Confidence is the essence of trust. *Culpa in contrahendo* doctrine is contractual duty of disclosure in the interests of fair dealing. The parties are 'bound to disclose matters as are clearly of importance for the other party's decision ...'[236] extending legal obligation beyond contract and codified in statute.[237]

For investors, does 'the client ha[ve] the necessary knowledge and experience to understand …'[?][238] It is contract law recognising a duty to negotiate with care and ensure that the counterparty has the required information to conduct the negotiation sufficient not to cause that party detriment should they enter into a contract. Each party has a duty of disclosure to the other even if the counterparty cannot access that information themselves. Failure leads to restoration of the status quo ante similar to equitable remedy. *Culpa in contrahendo* is to ensure symmetry of knowledge, competence, enforcement of loyalty and trust.

Statutory protection[239] extends beyond the contracting parties to third parties where there is a loyalty or influential relationship.[240] German courts have 'stretched the concept of a contract':[241]

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[232] *Civil Code* (Germany) 1907 ('BGB') § 311(2); Sebastian Barry and Hannes Bracht, 'The Implementation of the MiFID into the WpHG' (2008) 9(9) *German Law Journal* 1177, 1185.
[233] Barry and Bracht, above n 232, 1185.
[234] Kalss, 'Civil Law Protection of Investors in Austria', above n 151, 225.
[235] Ibid.
[236] Friedrich Kessler and Edith Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A comparative Study* (Faculty Scholarship Series Paper 2724, Yale Law School Scholarship Repositary, 1964).
[237] *Civil Code* (Germany) 1907 ('BGB') § 311(2).
[238] Barry and Bracht, above n 232, 1185.
[239] *Civil Code* (Germany) 1907 §§ 241 (2), 311(3).
[240] Michael Coester and Basil Markesinis, 'Liability of Financial Experts in German and American Law: An Exercise in Comparative Methodology' (2003) 51 *American Journal of Comparative Law* 275, 290.
[241] Ibid 288.

> The emphasis of the judgments has drifted away from the contract … and placed more and more on the professional duties of the expert and the high degree of trust and reliance which is normally attributed by the public at large to expert opinions … the basis of the liability of experts flows directly from their professional status and not from some kind of contractual bond …[242]

In Germany, misleading disclosures in offer documents, false representations, negligent asset valuations and breaches of trust can lead to remedy under the *culpa in contrahendo* doctrine.[243] Banks and others acting in a fiduciary capacity are 'obliged to explore the customer's profile' and to disclose conflicts of interest.[244] This 'far-reaching and groundbreaking'[245] decision [*Deutsche Bank*] means:

> [i]t is the duty of the advising bank to present all suitable alternatives to a client to ensure that the latter can make an informed decision. Therefore the bank must know the customer's individual objectives and willingness to take risks, and cannot derive these merely from the client's knowledge concerning one specific product.[246]

If Australian NBFE directors were subject to these civil law *untreue* and *culpa in contrahendo* fiduciary doctrines (in their proscriptive and prescriptive formulations), supreme rather than subordinate, they would be less likely to hide behind statutory and contractual box-ticking. For Australian investors, it would extend duties of advisers beyond present statute with a personal conduct obligation to explain, fully disclose, deal fairly and positively pursue their economic interests. The law matters: in Germany it facilitated the maturity of its private banking sector, yet to be emulated in Australia.

3.2.2 Fiduciaries in Germany: differences between common and civil law jurisdictions

Formulation of directors' duties varies across the EU.[247] There is no intra-EU harmonisation. Common law jurisdictions are trust law based and, until recently in the UK, uncodified.[248] 'Fiduciary duties in Germany are only ever creatures of contract'.[249]

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[242] Ibid.
[243] Ibid 289.
[244] *Securities Trading Act* (Germany) 1998 ('WpHG') § 31(4); see especially Jean David Jansen, 'Case Note – Judgment of the Bundesgerichtshof [Federal Court of Justice of Germany] of 22 March 2011: Passion to Inform – BGH Expands Banks' Advisory Duties' (2011) 12 *German Law Journa*l 1500.
[245] Jansen, above n 244, 1492.
[246] Ibid 1502.
[247] Carsten Gerner-Beuerle and Edmund-Philipp Schuster, 'The Evolving Structure of Directors' Duties in Europe' (2014) 15 *European Business Organisation Law Review* 191, 196.
[248] *Companies Act* (UK) 2006 ss 171–177, 178(2).
[249] Jason Grant Allen, 'More than a matter of trust: the German Debt Securities Act 2009 in international perspective' (2012) 7(1) *Capital Markets Law Journal* 55, 76.

> Civil law jurisdictions are less familiar with the concept of the trustee; they have not developed a clear distinction between trust and agency. Rather, they generally assume that certain principles of good faith and honesty underlie all contractual or commercial relationships.[250]

Transfer of governance systems from common law to civil jurisdictions may ‘fundamentally misunderstand the underlying concepts of German law’.[251] Fiduciary relationships arise from agency and contract rather than trust law of common law jurisdictions. The German *Civil Code* does not prescribe fiduciary standards of care.[252] The contract defines the fiduciary standards applied to the commercial relationship, not trust law.

Germany has moved towards ‘specific and express duties’,[253] and has statutory duty for directors and fiduciaries to avoid conflicts of interest.[254]

> The differences between common law and civil law … seems to have lost much of its relevance as corporate law reforms benefit from mutual learning and legal concepts are diffused internationally even without harmonisation efforts at European level.[255]

Diffusion of German civil law concepts could benefit Australia. Diffusion already occurs in Australia between ASIC and APRA, providing transposed solutions to similar problems. A striking example of this type of international coordination and interaction is the dispersion of the US business judgment rule in the EU.[256]

> Delaware case law nudges corporations into subjecting RPT’s [Related Party Transactions] to procedural safeguards: the more rigorously these safeguards are complied with, in form as well as substance, the less the judges will be inclined to rule for the plaintiffs by finding that its terms themselves are substantially unfair.[257]

German and Australian jurisdictions both impose duties of skill and care, and of fidelity, but applied and enforced differently. In ’Germany, private enforcement of the duty of care is very low’.[258] The

[250] Gerner-Beuerle and Schuster, above n 247, 197; *Civil Code* (Germany) 1907 (‘BGB’) § 242.
[251] Wolf-Georg Ringe, ‘Independent Directors: After the Crisis’ (2013) 14 *European Business Organisation Law Review* 401, 419.
[252] Allen, above n 249, 76.
[253] Gerner-Beuerle and Schuster, above n 247, 198.
[254] *Stock Corporation Act* (Germany) 1965 (‘AktG’) § 93(1); *Securities Trading Act* (Germany) 1998 (‘WHpG’) § 31(4); Gerner-Beuerle and Schuster, above n 247, 198.
[255] Gerner-Beuerle and Schuster, above n 247, 198.
[256] Ibid 230.
[257] Enriques, above n 218, 24.
[258] Gerner-Beuerle and Schuster, above n 247, 199.

statutory duty of care,[259] being that of a conscientious and diligent manager is enforced by public authorities based on an objective standard of ‘a prudent businessman with the knowledge and expertise that can reasonably be expected of a person in a comparable situation’,[260] with the director bearing the burden of proof. This reversal of proof also applies to protections afforded by statutory and judicial interpretations[261] of business judgment rules despite Germany following Delaware interpretations of that doctrine. The tests of reasonable belief and best interest recur in statute [262] and in general law. There is a ‘general dearth of case law, courts accept a degree of managerial discretion and acknowledge that directors must be allowed to take risks inherent in economic activity’.[263] Nonetheless, German courts may second guess and intrude on commercial decisions of directors. ‘there is a borderline between the violation of the duty of care and loyalty on the one hand and entrepreneurial faults in the conduct of the company on the other hand’.[264]

Modern European law incorporates the trust,[265] with common features and common sources of law. There is an analogy with English trust law, not necessarily exact.[266] Trust (*Treuhand*) property similarly held by a trustee (*Treuhänder*) in a fiduciary capacity. Trust property is vested with ‘unrestricted and exclusive ownership with its inherent illimitable power of disposition.’[267] The beneficiary’s (settlor) ownership is secured by contract regulated under the *German Civil Code* with the trustee to determine the disposition of the trust property. ‘[E]quitable ownership can[not] subsist in the settlor side … with the legal ownership of the trustee [being] alien to German law.’[268] Many German NBFEs described as trusts are used for pooled investment under agency principles and for investment mandates. These contracts are fundamental to the rights of the beneficiaries who cannot rely on English equitable principles in seeking remedy. Claims are limited to damages in contract

259 *Stock Corporation Act* (Germany) 1965 (‘AktG’) § 93(1).
260 Gerner-Beuerle and Schuster, above n 247, 202.
261 *Gesetz zur Unternehensintegrtät und Modernisierung des Anfechtungsrechts* [Law Furthering Corporate Integrity and Modernisation of the Regime Covering Shareholder Actions] (Germany) 2005, 2802 (‘UMAG’); See *ARAG/Garmenbeck*, Bundesgerichtshof [Federal Court of Justice] 11 ZR 175/95 (April 1997) 135, 244.
262 *Stock Corporation Act* (Germany) 1965 (AktG’) § 93(2).
263 Gerner-Beuerle and Schuster, above n 247, 205.
264 *ARAG/Garmenbeck*, Bundesgerichtshof [Federal Court of Justice] 11 ZR 175/95 (April 1997) 135, 244; See also York Schnorbus, ‘Tracking Stock in Germany: Is German Corporate Law flexible enough to adopt American financial innovations?’ (2001) 22 *University of Pennsylvania Journal of International Economics and Law* 541, 613.
265 Richard Helmholtz and Reinhard Zimmerman, *Itinera Fiduciae: Trust and Treuhand in Historical Perspective: Comparative Studies in Continental and Anglo-American Legal History — Band [vol] 19* (Duncker and Humblot, 2013).
266 Hans Würdinger, ‘The German Trust’ (1951) 33(3d series) *Journal of Comparative Legislative and International Law* 31.
267 Ibid.
268 Ibid 32.

against the trustee[269] since there is no beneficiary equitable interest. German trust law does not apply in cases where the verb trust is used in commerce rather than as strict legal interpretation.

3.3 United Kingdom

3.3.1 Statutory discomfort

Lack of statutory financial advice best interest obligation led to analysis of the extent of general law fiduciary duties and to whom these duties are applied, the objective being to 'address uncertainties and misunderstandings on the part of trustees and their advisors'.[270]

> Amongst the questions being asked was whether fiduciary duties apply to all those in the 'investment chain' and how far must fiduciaries focus exclusively on maximising financial return to the exclusion of other factors.[271]

UK analysis illustrates the discomfort with incremental statutory reform 'due to difficulties in defining fiduciary duties, which difficulties would multiply with statutory reform and result in new uncertainties and possible unintended consequences'.[272] This is important policy analysis relevant to Australia. Statutory interventions in Australia are encouraged by vengeful community demand for its expectations to be better met. Sober UK reflections of this conundrum provide some insight:

> Fiduciary duties are difficult to define and inherently flexible. We think that is one of their essential characteristics: they form the background to other more definite rules, allowing the courts to intervene where the interests of justice require it … [I]f there is a need for greater certainty in some areas, we think it would be better to enact specific duties rather than attempt to codify an area of law which has always depended on the facts of the case.[273]

Consequently, the direction of UK regulatory policy is toward embedding 'legal duties in an industry structure which provides the expertise and resources for good governance.'[274] This is similar theory underpinning the Canadian SRO model. Australia would be wise to contemplate it.

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[269] Ibid 38.
[270] Paglia, above n 102, 21.
[271] Ibid 20 citing *Fiduciary Duties of Investment Advisers* (Law Commission UK Consultation Paper No 215, 22 October 2013) [11 145].
[272] Ibid citing *Fiduciary Duties of Investment Advisers* (Paper No 215), above n 271.
[273] *Fiduciary Duties of Investment Advisers* (Paper No 215), above n 271.
[274] Paglia, above n 102, 22 citing *Fiduciary Duties of Investment Advisers* (Paper no 215), above n 271.

3.3.2 Creative compliance

The UK experienced systemic economy-wide regulatory failure in 2008. '[T]here was an inadequate focus on the analysis of systemic risk and the sustainability of business models.'[275] '[R]isk has materialised in an extreme form without triggering a significant set of [conflict of interest] rules intended to mitigate risk.'[276] '[S]ince 2009, UK banks have paid almost £35 billion in fines and redress costs, roughly equivalent to the private capital they have raised in the same period.'[277] Globally, redress and costs are USD275 billion … since 2008 [which] translates into more than USD5 trillion of reduced lending capacity to the real economy'.[278] This is an economic loss multiplier effect of approximately 18 times, much of it attributed to 'unmanaged conflicts of interest.'[279] These data do not account for concurrent economic losses in the NBFE sector which have now been quantified in Australia.[280]

Market failure arguments are used to support regulatory interventions without 'considering how it might be resolved through techniques other than [further] regulatory intervention'.[281] There are already more than 100 conflict of interest provisions in the FCA Handbook.[282] The 'progress of regulatory reform in the UK has been relatively slow',[283] partly, as in Australia, a result of political disagreements. Traditionally 'light touch'[284] (a caricature) and general law focussed,

> the new model of supervision is designed to deliver a more intrusive and direct regulatory style than the FSA [now FCA] previously adopted and requires a 'braver' approach to decision-making by supervisors … in favour of a more overt and aggressive philosophy of 'credible deterrence'.[285]

Some UK institutions, and foreign ones operating inside the UK had been undertaking bank-like activities without being prudentially regulated. Hedge funds, private equity funds, mutual funds and various forms of special investment vehicles, collectively constituting the shadow banking sector

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[275] Iain Anderson, *Summary of the Turner Review* (Cicero Consulting Limited, 18 March 2009) 5.
[276] Iain MacNeil, 'The Trajectory of Regulatory Reform in the UK in the Wake of the Financial Crisis' (2010) 11 *European Business Organisation Review* 483, 524.
[277] Minouche Shafik, 'From "ethical drift" to "ethical lift" ― Reversing the tide of misconduct in global financial markets' (Panel Discussion at the Federal Reserve Bank of New York Conference on Reforming Culture and Behaviour in the Financial Services Industry, 20 October 2016) 2.
[278] Ibid.
[279] Ibid.
[280] See ch 3, author's empirical data from analysis of senior court judgments 1981-2018.
[281] MacNeil, above n 276, 525.
[282] Ibid 523.
[283] Ibid.
[284] Ibid 497 citing A Turner, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (Financial Services Authority UK, 2009) 86 ['Turner' or 'Turner Review'].
[285] Ibid 497.

engaged in regulatory arbitrage.[286] As in Australia where many non-prudentially regulated MIS failed, regulation followed legal form rather than economic substance. The *Turner Review*[287] led to 'intensive supervision … of the sustainability of business models, skills sets of directors [rather than probity considerations alone], and enhanced prudential regulation'[288] of NBFEs. Turner 'questioned how effective market discipline had been…'[289] favouring compliance based regulation. As in other jurisdictions, market failure is used as an excuse for government intervention, 'more invasive regulation and supervision',[290] evidenced in Australia by the constant growth in the size and complexity of its *Corporations Act*. However,

> it is socio-technical factors such as human behaviour, corporate culture and organisational structure that are the underlying … causes of all disaster and crises.[291]

Ashby is critical of the Turner market discipline failure thesis. Germany insulated itself from post-2004 subversion of its traditions with its two tier board structure and civil law doctrines.

> They [Turner] fail to explain why regulators did not deal with a clear case of 'creative compliance' – the growth of the shadow banking sector. Moreover, they do not seem to realise that more costly/prescriptive regulation is only going to make the problem worse.[292]

Creative compliance (alternatively regulatory arbitrage) is the result: 'the use of legal loopholes in order to allow the legitimate circumvention of criminal/civil laws and regulations.'[293] In Australia, there are similar echoes of creeping corruption where narrowly defined statutory rights subvert the economic interests of investors and beneficiaries.

> It [creative compliance] is essentially the practice of using the letter of the law to defeat its spirit, and to do so with impunity.[294]

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[286] Anderson, above n 275, 7.
[287] Turner, above n 284.
[288] Anderson, above n 275, 12.
[289] Ibid 16.
[290] Simon Ashby, *The Turner Review on the Global Banking Crisis: A Response from the Financial Services Forum* (Nottingham University, 2009) 12.
[291] Ibid 3.
[292] Ibid 15.
[293] Ibid 17.
[294] Ibid.

The UK, partly from political pressure is moving toward prescriptive intensive supervision, despite the fact '[t]hat our regulators have been part of the problem'.[295] That this may stifle innovation and growth appears immaterial.

> The *Turner Review* … virtually ignor[es] the key underlying behavioural issues that lead us to the mess that many western economies are now in. Moreover they show a lack of faith in market forces that is at odds with the prevailing theory and practice in this area.[296]

Whilst:

> no single reform will provide the solution, [reform] must emphasise the central role of trust in financial intermediation [and] restore relationships of trust and confidence in the investment chain, underpinned by the application of fiduciary standards of care by all those who manage or advise on the investments of others.[297]

3.3.3. The veracity of the investment chain

The UK, like Australia, has determined not to codify fiduciary duties, despite compelling advice to the contrary.[298] Regulatory policy debate between financial and behavioural economists, and those preferring statutory intervention continues in the UK. It resists the German thesis of investors as consumers providing for their own future rather than the traditional view of investors as capital suppliers in an efficient market.

> Regulatory policy has given little attention to issues of market structure and the nature and effectiveness of competition, instead developing detailed and often prescriptive rules governing market conduct, with substantial cost and limited success. … We look forward to a future of less intrusive and more effective regulation … and to the creation of trust relationships which can give savers and companies confidence that equity investment chain meets their needs and serves their interests.[299]

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[295] Ibid 33.
[296] Ibid 17.
[297] John Kay, *The Kay Review of UK Equity Markets and Long Term Decisions Making* (Final Report, Department of Business, Innovation and Skills UK, July 2012) 9 ['Kay' or 'Kay Review'].
[298] Ibid.
[299] Ibid 11 [xvi].

There is recognition that ‘hard law is not enough’,[300] and that [r]egulators cannot police every market practice … nor can they dictate a firm’s culture.’[301] Australia contemplates both. The UK solution includes Canadian style SRO typology ‘to raise expectations and norms.’[302]

Mass consumption of financial products and services implies vulnerability. Vulnerability implies the application of fiduciary obligation. Trust in the investment chain is only as ‘strong as the trust in the weakest link of that investment chain’.[303] In the UK, despite Turner inspired supervision of business models, directors’ skills sets and investor outcomes, compliance based regulation does not achieve the same ‘standards implied by fiduciary duty’.[304] Fiduciary relationships can be found at every point in the investment chain where there is discretion or advice. This stems from the economic interest of investors and pension beneficiaries to whom various intermediaries in the investment chain provide services. The beneficiary must have confidence in the agent. This principle has often been subsumed by caveat emptor in financial products selling and, as in Australia, leads to the ignorance of or ignoring of fiduciary obligation. There is considerable uncertainty in the investment chain as to who is a fiduciary and to whom the fiduciary owes duty.

> Regulatory authorities at the EU and domestic level should apply fiduciary standards to all relationships in the investment chain which involve discretion over the investments of others, or advice on investment decisions. These obligations should be independent of the classification of the client, and should not be capable of being contractually overridden.[305]

The intent is to re-establish trust, confidence and respect, lost in several decades of often anonymous or poorly informed financial product selling, despite similar analysis and conclusions from 2001.[306] This outcome is unlikely to be achieved with prescriptive administrative regulation. The economic interests of investors and beneficiaries supported by holistic fiduciary standards in the investment chain is a different proposition from compliance with regulation. As in Australia, it leads to a different result: creative compliance, creeping corruption, and regulatory arbitrage. It also leads to different approaches to conflicts of interest. Identifying, disclosing and managing conflicts of interest in a complex investment chain controlled by multiple intermediaries must be compatible with the concept of a fiduciary having stewardship of others’ property.

[300] Shafik, above n 277, 3.
[301] Ibid.
[302] Ibid 7.
[303] Kay, above n 297, 65.
[304] Ibid 67.
[305] Ibid rec 7 67.
[306] Lord Myners, *Institutional Investment in the UK: A Review* (HM Treasury, March 2001).

3.3.4 The unresolved UK fiduciary debate

The need for reform was accepted by the UK authorities, but did not extend to the adoption of statutory fiduciary duties of those in the investment chain.[307] Rather, best interest is interpreted as best long term interest consistent with the *Companies Act*.[308] It 'enshrines …"enlightened shareholder value"'[309] and 'generally prevailing standards of decent behaviour'.[310] For superannuation entities, best interest, as in Australia, means best financial interest, being consistent with the sole purpose test.[311] These standards incorporate concepts of stewardship[312] into the governance and practice of UK NBFEs some of which are required to report or publicly disclose compliance.[313] Whilst administrative, voluntary (except for listed companies) and resting in the duty of care, it implies the application of fiduciary principles to participants in the investment chain rather than an explicit statutory fiduciary duty. It also implies an extension of those fiduciary principles from proscription to positive duties. As in the Australian *FoFA* reforms for retail financial advice, this is at variance with general law interpretation of fiduciary duty. 'Some stakeholders argue[d] that stewardship should be "an explicit part of fiduciary duty"'.[314] The present position is a voluntary adoption of the *Stewardship Code* with explanations required for non-adoption (as in Germany).[315] Fiduciary duties may arise in contractual relationships.[316] Importantly for Australian NBFEs, particularly for common enterprise MIS:

> Even where the relationship is contractual (as it normally will be), the matter is too important to be left entirely to the agreement of the parties and the interpretation of that agreement … A too casual failure to recognise the requirements of a fiduciary position, and sometimes a short sighted assumption that all relevant duties are prescribed in contract, can be and has been responsible for serious misbehaviour in the financial markets and elsewhere, as shown by many litigated cases in the last quarter-century.[317]

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307 *Fiduciary Duties of Investment Advisers* (Paper No 215), above n 271, 4.
308 *Companies Act 2006* (UK) s 172.
309 *Fiduciary Duties of Investment Advisers* (Paper No 215), above n 271, 63.
310 Ibid 5.
311 *Cowan v Scargill* [1985] Ch 270 [287]; 3 WLR (10 August 1984) 502 520 (Megarry V-C).
312 *The UK Stewardship Code* (Financial Reporting Council, 2012) Principle 1.
313 *Conduct of Business Source Book* (Financial Conduct Authority UK) 2.2.3R.
314 *Fiduciary Duties of Investment Advisers* (Paper No 215), above n 271, 144 citing Lord Myners (Third Report of the Select Committee on Business, Innovation and Skills UK, 2013–14) House of Commons 603 Evidence 19.
315 *Fiduciary Duties of Investment Intermediaries* (Law Commission UK, Paper No 350, 30 June 2014) [5.83].
316 *Fiduciary Duties of Investment Advisers* (Paper No 215), above n 271, 171 citing Peter Watt (ed), *Bowstead & Reynolds on Agency* (Sweet & Maxwell, 19th ed, 2010) [6–043].
317 Ibid.

This analysis is central to some systemic causes of NBFE failure in Australia and the UK. Its partner is subsuming fiduciary obligation by statutory compliance. It led to calls by Kay and Myners for all financial intermediaries in the investment chain to be fiduciaries and eliminate the possibility of contracting out of those fiduciary obligations. They also propose that duties should be owed to the end client, and not to the proximal intermediary.[318] Their views underscore the expectations gap between financial intermediary and their clients in the community. '[T]he term "fiduciary duty" means different things to lawyers and non-lawyers. Even lawyers use the term in different ways.'[319] 'Plaintiffs and their advisers have discovered the apparent advantage of alleging breach of trust or fiduciary duty, … inappropriate references to these concepts which are often scattered throughout the pleadings with complete abandon'.[320]

> I think Kay is absolutely right in emphasising this issue of fiduciary responsibility … We need to place great clarity around the concept of the intermediary – the adviser – acting wholly and unquestionably in the best interest of the client. At the moment, we know that is not the case. The test is one of fairness and disclosure, and Kay himself makes the point that in, for instance, the area of what he calls 'stock lending', disclosure is inadequate … There needs to be clarity about fiduciary responsibility, backed by a tough regulatory regime that says: if you misbehave, you are out – and for good. For the life of me, I cannot understand why the Department for Business, Innovation and Skills has not got on with the process of getting the Law Commission to work on the Kay recommendation.[321]

'Equity's place in the law of commerce, long resisted by commercial lawyers, can no longer be denied.'[322] This applies particularly to the application of 'fiduciary duty and constructive trust'[323] in commercial relationships. Fiduciary duties in superannuation NBFEs are well established in UK law. Some UK superannuation schemes are trust based rather than contract based. UK contract based schemes are regulated by the FCA; trust based schemes are subject to trust law administered by The Pensions Regulator (TPR).[324]

There are many examples of positive duties in the FCA Handbook which echo fiduciary duties, but they do not raise standards to fiduciary level. Whilst:

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[318] Ibid [1.9], 242.
[319] *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 315, [3.11].
[320] Ibid [10.4] citing P Millet 'Equity's place in the law of commerce' (1998) 114 *Law Quarterly Review* 214, 217.
[321] Lord Myners, (Third Report of the Select Committee on Business, Innovation and Skills UK, 2013–14) House of Commons 603 Evidence 19.
[322] Millet, above n 320.
[323] Ibid.
[324] *The Pensions Act 1995* (UK).

> The FCA has stressed the need to stay clear of a more intrusive approach towards firm's management of regulated duties, such as conflicts of interest,[325] the FCA Handbook is now too large to fit in a hand. In fact it is no longer a printed book [printed copies can be obtained], but a complex database, which may appear daunting to outsiders … [i]t is however central to the way UK financial markets work.[326]

'We have not been asked to review the FCA Handbook. That is a mammoth undertaking…'[327] Presently, the FCA Handbook also incorporates EU policy and directives, including MiFID2.

Given the centrality of trust and confidence by the vulnerable in those that advise them, why, despite scholarly advice to the contrary the principles of which were accepted,[328] is the UK reluctant to embrace statutory fiduciary obligation on financial advisers and financial product sellers?

A first argument: '[t]he principles set out in the Kay Review are so far removed from the courts' interpretation of fiduciary duties…'[329] Why, as generally in Australia, are the economic interests of investors and beneficiaries subsumed by processes of statutory compliance? Canada, Singapore, and Germany in differing degrees have embarked on a different journey, partly because they are cognisant of behavioural economics research.

As in Australia, judicial tradition in the UK interpretation of fiduciary duties rests upon historical doctrines, not modern empirical behavioural economics research. 'The greater the degree of trust, vulnerability, power and confidence reposed in the fiduciary, the more likely that a reasonable person would have such an expectation.'[330] Expectations of fiduciary status may not attract judicial support.[331] Who is categorised as a fiduciary therefore is of paramount importance to the community. This is the second argument. Historically, 'this is a "notoriously intractable" problem[332] … [a] vague protean ethical standard embodied by the fiduciary obligation'[333] … [I]t is not easy to attempt to

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[325] *Fiduciary Duties of Investment Advisers* (Paper No 215), above n 271, 111.
[326] Ibid 59.
[327] *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 315, [11.36].
[328] Ibid [11.6].
[329] Ibid [1.12].
[330] Ibid [3.23] citing J Edelman, 'When do fiduciary duties arise?' (2010) 126 *Law Quarterly Review* 302.
[331] *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594–600 (Lord Steyn, Lord Lloyd, Lord Hobhouse, Sir Andrew Leggatt, Henry JJ) [1998] 3 NZLR 680. This case was ultimately determined on appeal to the Privy Council.
[332] *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 315, [3.14] citing Ernest Weinrib, 'The Fiduciary Obligation' (1975) 25(1) *The University of Toronto Law Journal* 1 [5].
[333] Weinrib, above n 332, [22].

define the circumstances in which a fiduciary relationship will be found to exist.'[334] Tests include degree of mutual trust, confidence, and reliance.[335]

'The existence of a fiduciary relationship does not in itself determine the content of the duties owed by a fiduciary to their principal.'[336] Nor does it interfere with the non-fiduciary duties of a fiduciary.[337] Proscriptive UK[338] (and Australian)[339] judicial tradition resting upon notions of informed consent and best interest (in the UK meaning best long term interest and for the purposes the trust was created, but not necessarily best financial interest)[340] do not meet community expectations. Regulation has many prescriptive duties, but these do not have fiduciary status in the UK.

A third argument rejecting statutory fiduciary duty was expressed as: '[e]quity's flexibility is important in ensuring that the law retains sufficient suppleness to cope with the social developments which the court is asked to sit in judgment.'[341] Prohibition on contracting out of equitable obligations would apply to contract based pensions where: 'a member has a legitimate expectation that the provider will act in the member's best interest. In many cases, the contract terms will mean that such an expectation will not be legitimate…'[342] Australian echoes are to be found in its NBFEs, particularly common enterprise MIS. Common elements include failures in disclosure, fees, information asymmetry, financial literacy, and advice. Like the conflicted RE model in Australia, UK:

> [W]orkplace D[irect] C[ontribution] pensions do not always operate in the best interest of savers. Although these problems apply to both trust-based and contract-based schemes, they are particularly

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[334] *News Limited v Australian Rugby Football League Limited v New South Wales Rugby League Limited* [1996] FCA 1256 [312] (Burchett J) cited in *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 315.
[335] Ibid [312]–[316] (Burchett J) cited in *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 315.
[336] *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 315, [3.37] citing *News Limited v Australian Rugby Football League Limited* [1996] FCA 870 [158].
[337] *News Limited v Australian Rugby Football League Limited* [1996] FCA 870 [156].
[338] *Attorney-General v Blake Jonathan Cape Ltd* [1998] Ch 439 [455] (Woolf MR, Millett and Mummery JJ).
[339] See, eg, *Breen v Williams* (1996) 186 CLR 71 [95],[113],[137]–[138] (Brennan CJ, Dawson, Toohey, Gaudron, McHugh, Gummow JJ); *Pilmer v Duke Group Ltd (in liq)* [2001] HCA 31 [71],[74],[127] (McHugh, Gummow, Kirby, Hayne and Callinan JJ); *Youyang Pty Ltd v Minter Ellison Morris Fletcher* [2003] HCA 15 [40] (Gleeson CJ, McHugh, Gummow, Kirby and Hayne JJ); *Aequitas v AEFC* [2001] NSWSC 14 [278]–[291] (Austin J).
[340] *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 315, [4.82]; Lord Nicholls, 'Trustees and their Broader Community: Where Duty, Morality and Ethics Converge (1996) 70 *Australian Law Journal* 205, 211, 215
[341] *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 315, [7.37].
[342] Ibid [8.48].

> acute in contract-based schemes which do not have the equivalent of the trustee board to represent the needs of scheme members.[343]

Most of these commercial relationships are contractual, with traditional reluctance to interfere in arms-length contracting parties.[344] Nonetheless, judicial tradition conflicts with administrative practice. '[T]he obligation to act in the best interest of clients may not be contractually overridden.'[345] Such practice recognises the importance of fiduciary obligation to be more than a set of default rules or 'legal polyfilla'[346] where all else fails.

Fiduciary duties are traditionally owed to whomever has the immediate economic interest.[347] However, investment chains can be long and include many participants. Reform proposals are for the duty to be extended to the end investor (with investor classification irrelevant), rather than the intermediary. The fourth argument denies this proposal other than in specific circumstances,[348] with 'courts appear[ing] reluctant to impose such duties.'[349] A fifth argument rests upon the uncertainty in the general law of fiduciaries and the practical inability of the vulnerable to mount equitable challenges to malfeasance.

So reform to increase accountability in financial services and financial products regulation rests upon these tenets: increasing the breadth of fiduciary obligation to all elements of the investment chain; increasing its depth by eliminating contracting-out powers and by making the end investor a party to the obligation; introducing prescriptive duties; and reducing general law uncertainty by statutory intervention. These principles are not contested, despite judicial reticence and tradition. The means to achieve them however is 'through regulation rather than law reform,'[350] as in Singapore. Behavioural economics in financial literacy suggests that specific interventions improve results. There is a tendency to confuse principles based regulation, including reliance on fiduciary obligations, with light touch regulation: 'a principles-based approach does not work with individuals who have

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343 Ibid [8.64].
344 See, eg, *Hospital Products Ltd v US Surgical Corporation* [1984] HCA 64 [100]–[102] 71 (Gibbs CJ, Mason, Wilson, Deane and Dawson JJ); *Paul Dainty Pty Ltd v National Tennis Centre Trust* (1990) 22 FCR 495, 515–516.
345 *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 315, [10.49] citing *Conduct of Business Sourcebook* (Financial Conduct Authority UK, 14 October 2014) Principle 2.1.1.R.
346 Ibid [3.1].
347 *Daly v Sydney Stock Exchange Ltd* [1986] HCA 25 [3] (Gibbs CJ, Wilson, Brennan and Dawson JJ); *Hunt v TD Securities Inc* (2003) 66 OR (3d) [35]–[37] (Simmons, Gillese, and Armstrong JJA).
348 *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windso*r [1995] FCA 1663 [47]–[58] (Finn J); *ISPT Nominees Pty Ltd v Chief Commissioner of State Revenue* [2003] NSWSC [244]–[246] (Barrett J).
349 *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 315, [10.75].
350 Ibid [11.8].

no principles'.[351] This is not the case: the proposed extension of fiduciary responsibility may act as Damoclean Sword over prospective malfeasors, and is certainly not 'light touch'.

3.3.5 Directors as fiduciaries

Reluctance to embrace statutory fiduciary duty in the investment chain also extended to the codification of fiduciary and common law duties of company directors and officers.[352] It attempts to codify case law 'which spans over one hundred and fifty years. A central concern is whether the statutory language adequately encapsulates the nature of the fiduciary relationship'.[353] It purports to replace general law[354] whilst relying on it for statutory meaning and remedy.[355] Differing drafting typology and the omission of the adjectives loyalty[356] and fiduciary make for legal complexity in conflicts of interest and related party situations.

> [D]espite the aim of 'the code' being to increase accessibility, transparency and comprehensibility … [w]hat has been done does not satisfy those criteria, and leaves directors in a somewhat confused position.[357]

That confusion, as with fiduciary duty in the investment chain, leads to 'an incomplete picture of the law, particularly in relation to remedies'.[358] Codification of directors and officers duties, including their fiduciary duties, is incomplete: a 'patchwork'.[359] Duties are codified but 'there is a total reliance on the general law remedies for a breach, or potential breach, of the "general duties" … being curious and puzzling'.[360] Directors of NBFEs may have parallel and competing fiduciary duties to clients and others. Codification of directors' fiduciary duties has widened the traditional responsibility to the company alone.[361] As in Canada, UK directors are required to 'have regard'[362] to a wide range of factors in their exercise of duties and strive for long term economic value increments. They must also

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[351] MacNeil, above n 276, 499.
[352] *Companies Act 2006* (UK) pt 10 ss 170–78.
[353] John Lowry, 'Codifying the corporate opportunity doctrine: The (UK) Companies Act 2006' (2012) 5(1) *International Review of Law* 4.
[354] *Companies Act 2006* (UK) s 170(3).
[355] Ibid s 170(4).
[356] *Meinhard v Salmon* 164 NE 545 (NY 1928) (Cardozo J) cited in *Item Software (UK) v Fassihi* (Arden LJ) quoted in Lowry, above n 353, 9.
[357] Parker Hood, 'Directors' Duties under the Companies Act 2006: Clarity or Confusion' (April 2013) 13(1) *Journal of Corporate Legal Studies* 1, 48.
[358] Ibid 47.
[359] Ibid 6.
[360] Ibid 7–8.
[361] *Percival v Wright* [1902] 2 Ch 421. See also *Coleman v Myers* [1977] 2 NZLR 225, 227. Contextual exceptions to the general rule may occur where a shareholder relies on or is vulnerable to the actions of the director.
[362] *Companies Act 2006* (UK) s 172(1).

be cognisant of political pressures manifested as corporate social responsibility with its interventions from international institutions [363] and modernisation of UK statutes designed to broaden responsibility and extend the reach of the statute.[364]

Codification and mandatory widening results in the UK being 'the only jurisdiction in which the legislature adopted a directive approach, mandating directors to have regard to a range of matters in promoting "the success of the company for the benefit of its members as a whole"'.[365] Furthermore:

> The UK *Companies Act* is the only one which expressly provides that the statutory principles in relation to directors' statutory duties, even though based on common law rules and equitable principles, 'have effect in place of those rules and principles as regards the duties owed to a company by a director'.[366]

This legislative response arises partly from political pressure wrought by unmet community expectations of director behaviour. 'It is fair to say that courts and legislators have, overall, tended to follow and respond to heightened societal expectations over time.'[367] Notably, whilst duties are codified, remedies are not, relying on traditionalist judicial interpretation of general law, the result being 'distinctly pluralist in objective, but avowedly traditionalist in substance.'[368]

Additional nuances arise in general conflict of interest provisions[369] which are treated differently from director's dealings with their company.[370] General duties are implicitly fiduciary (apart from the duty of skill, care and diligence),[371] but couched as 'fiduciary obligations'.[372] Public companies (plc) are also subject to the '[N]on-legally binding, but hugely important, UK *Corporate Governance Code* …'[373] which has the force of the UK *Listing Rules*. UK NBFEs are also subject to the voluntary UK

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[363] Indira Carr and Opi Outhwaite, 'Controlling corruption through corporate social responsibility and corporate governance: theory and practice' (2011) 11(2) *Journal of Corporate Law Studies* 299, 302.
[364] *Bribery Act 2010* (UK); See also Commonwealth of Australia, Royal Commission into Trade Union Corruption and Governance (Final Report, December 2015) ch 4 [22]–[23] (Commissioner Heydon).
[365] Sulette Lombard and Tronel Joubert, 'The legislative response to the shareholders v stakeholders debate: a comparative overview' (April 2014) 14(1) *Journal of Corporate Law Studies* 211, 226.
[366] Ibid 228.
[367] Ibid 236 citing E Waitzer and E Jazwal, 'Peoples, BCE, and the Good Corporate Citizen' (2009) 47 *Osgoode Hall Law Journal* 439, 463.
[368] Ibid 219 citing S Worthington 'Reforming Directors' Duties' (2001) 64 *Modern Law Review* 440.
[369] *Companies Act 2006* (UK) s 175. See below s 5.3.
[370] *Companies Act 2006* (UK) s 177.
[371] Brenda Hannigan, 'Reconfiguring the No Conflict Rule: Judicial Strictures, a Statutory Restatement and the Opportunistic Director' (2011) 23 *Singapore Academy of Law Journal* 714, 743. See generally Brenda Hannigan, *Company Law* (Oxford University Press, 4th ed, 2018).
[372] *Companies Act 2006* (UK) s 178.
[373] Hood, above n 357, 42 citing *Corporate Governance Code* 2010 (rev 2014) (Financial Reporting Council Limited UK).

Stewardship Code which operates on a 'comply-or-explain basis …'[374] Despite the objectives of corporate law reform,[375] directors duties in the UK are thus partly subjective, and as with those involved in the NBFE investment chain, reliant upon the general law. '"[T]he code" as it stands is a halfway house.'[376] Doubtless, Kay and Myners would agree. UK government policy is not to 'impose impractical and onerous requirements which stifle entrepreneurial activity'.[377] Statutory intent [378] and strict judicial interpretation[379] may have the opposite result. With limited exceptions,[380] '[t]he authorities relating to directors' accountability not only do not support the scope of business exception in relation to the "no profit" rule, they are contrary to it.'[381] This is the subject of debate and legal clarification in the UK.[382] '[T]here are a number of uncertainties which have not been addressed by the statute and which remain to be resolved … it is for the court to build a more coherent doctrine using the statutory framework'.[383] This includes interpretation of conflicts of interest from misappropriation of corporate opportunity,[384] traditionally requiring the informed consent of the beneficiary or entrustor.

3.4 Canada

3.4.1 The distinctive nature of Canadian fiduciary law

Fiduciary traditions in Canada differ markedly from those in Australia, UK and Singapore in scope and responsibility. The Canadian regulatory system has much to offer Australia in its quest for reform of NBFE regulation. Canada 'has led the way in the common law world in extending fiduciary obligations and remedies',[385] to eliminate vague assertion of fiduciary expectations by the community

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[374] Lee Roach, 'The UK Stewardship Code' (2011) 11(2) *Journal of Corporate Law Studies* 463, 474.
[375] *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* (Law Commission UK, Consultation Paper No 153 and Scottish Law Commission Joint Consultation Paper, 1998).
[376] Hood, above n 357, 48.
[377] *Company Law Reform* (Department of Trade and Industry UK, Cm 6546, 2005) [3.3] cited in Hannigan, 'Reconfiguring the No Conflict Rule', above n 371, 743.
[378] *Companies Act 2006* (UK) s 994 cited in *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 1 BCLC 328 [1] (Sheldon DJHC).
[379] *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] EWCA Civ 751 [37]–[39] (Waller, Rimmer and Aikens LJJ).
[380] Ibid [61], [67] (Waller, Rimmer and Aikens LJJ).
[381] Ibid [56] (Waller, Rimmer and Aikens LJJ).
[382] David Kershaw, 'Does it matter how the law thinks about corporate opportunities?' (2005) 25 *Legal Studies* 533, 553 cited in Hannigan, 'Reconfiguring the No Conflict Rule', above n 371, 739.
[383] Hannigan, 'Reconfiguring the No Conflict Rule', above n 371, 742.
[384] *Companies Act 2006* (UK) s 175. See below s 5.3.
[385] Paul B Miller, 'A Theory of Fiduciary Liability' (2011) 56(2) *McGill Law Journal* 235 [4].

not met in practice. That phenomenon is not restricted to Australia: '[f]iduciary law everywhere has eluded a sound theory of liability'.[386]

> While inequality, dependence, and vulnerability are now routinely identified as qualities of fiduciary relationships that justify fiduciary duties, their meaning and salience have not been consistently stated or properly explained.[387]

In Canada and elsewhere there were implicit community fiduciary assumptions.[388] These have subsequently been given definition in Canada, requiring the existence of discretionary power of the fiduciary which can affect the legal position of the beneficiary.[389]

Cases have not yet determined whether acts of omission (for instance, not providing a client the universe of investment options), is an abuse of discretionary power, although there is no results based liability derived from a positive obligation.[390] There are echoes in recent Australian superannuation trust law.[391] Community expectations of fiduciary obligation, now enshrined in Canadian law, are based on 'the reasonable expectations of one person that another would act in his [practical] interests. This entails that a beneficiary may establish a fiduciary relationship unilaterally', provided there is a reasonable basis.[392] Discretionary power and practical interests are interrelated including matters of access, influence, and authority. This is where Canadian and Australian jurisprudence diverges (with the exception of Australian superannuation trustee duties).[393] The Canadian model is 'admirably capacious',[394] in Australia restricted to proscriptive economic interests,[395] not without criticism.[396] 'Nothing in the nature of fiduciary power suggests that it may be exercised only in relation to proprietary or economic interests'.[397] Conversely, from a community expectations perspective, '[f]eelings of exploitation feed naturally into fiduciary law's rhetoric of betrayal.'[398] Practical interests in Canada are expansive and include natural and artificial persons interests and objectives,

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[386] Ibid [5].
[387] Ibid [48].
[388] *Guerin v Canada* [1984] 13 DLR (4th) 321; See also *Hospital Products Ltd v US Surgical Corp* [1984] 156 CLR [72] (Mason, Gibbs, Dawson JJ).
[389] *Galambos v Perez* [1998] 166 DLR (4th) 475.
[390] Miller, above n 385, [50].
[391] M Scott Donald, 'Regulating for fiduciary qualities of conduct' (2013) 7 *Journal of Equity* 150.
[392] Miller, above n 385, [70].
[393] Donald, 'Regulating for fiduciary qualities of conduct', above n 391.
[394] Miller, above n 385, [102].
[395] *Paramasivam v Flynn* [1998] FCA 1711.
[396] Lisa Zhou, 'Fiduciary Law, Non-Economic Interests and Amici Curiae' (2008) 32(3) *Melbourne University Law Review* 1158.
[397] Miller, above n 385, [102].
[398] Richard Joyce, 'Fiduciary Law and Non-Economic Interests' (2002) 28 *Monash University Law Review* 237, 240.

physical and mental health, and decisions in relation to legal rights, property, and liabilities. These typologies do not draw upon the arbitrary distinctions applied in Australia, which '[p]ay[s] insufficient regard to the central concept of fiduciary obligations: the wrongful pursuit of self-interest or rival interests'.[399]

Best interest of a Canadian company has been subject of judicial review.[400] *BCE Inc*, (and its prior authority):[401]

> stands for the proposition that a fiduciary duty is a 'broad, contextual concept' not limited to short term profit or share value but relates to the long term interests of the corporation. The content of this duty varies with the situation at hand.[402]

This bears similarity with German best interest duties, directors in both jurisdictions having director business judgment protections. In Canada, '[t]here is no fiduciary duty to any particular group of these sets of stakeholders…'[403] but directors have discretion to consider them.[404] 'The fiduciary duty is indeterminate: there are no "corporate best interests" to look out for, but rather a range of competing stakeholder interests'.[405] There is a 'may/must consider ambiguity'[406] in directors' obligations.

Canada has also led the way in respect of fiduciary obligations of directors: 'The fiduciary duty of the directors to the corporation is a broad contextual concept … it looks to the long-term interests of the corporation.'[407] This broad conceptualisation of fiduciary obligations is prescriptive and extends to:

> the 'fair treatment' [of stakeholders]. There are no absolute rules[408] … a fiduciary duty to ensure that the corporation meets its statutory objectives,[409] and a fiduciary duty to ensure that the corporation is a 'good corporate citizen'.[410]

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[399] Ibid 266.
[400] *BCE Inc v 1976 Debenture Holder* [2008] SCC 69.
[401] *Peoples Department Stores Inc (Trustee of) v Wise* [2004] 3 SCC 461.
[402] Paglia, above n 102, 41.
[403] Jeremy D Fraiberg, 'Fiduciary Outs and Maximising Shareholder Value following BCE' (2009) 48 *Canadian Business Law Journal* 213, 216.
[404] Edward Iacobucci, 'Indeterminacy and the Canadian Supreme Court's Approach to Corporate Fiduciary Duties' (2009) 48 *Canadian Business Law Journal* 232, 234.
[405] Ibid 241.
[406] Ibid 245.
[407] *BCE Inc v 1976 Debenture Holders* [2008] SCC 69 [38] (McLachlin PC, Bastarache, Binnie, LeBel, Deschamps, Abella and Charron JJ).
[408] Ibid [82] (McLachlin PC, Bastarache, Binnie, LeBel, Deschamps, Abella and Charron JJ).
[409] Ibid [38] (McLachlin PC, Bastarache, Binnie, LeBel, Deschamps, Abella and Charron JJ).
[410] Ibid [66],[81]–[82] (McLachlin PC, Bastarache, Binnie, LeBel, Deschamps, Abella and Charron JJ); See generally Sarah P Bradley '*BCE Inc v. 1976 Debenture Holders:* The New Fiduciary Duties of Fair

This is a substantial expansion of fiduciary duties as traditionally understood, being both prescriptive and subjective with undeterminable consequences for directors and trustees. Fiduciary standards are designed to mitigate malfeasance reducing power imbalances resulting from asymmetries of knowledge and comprehension. They align interests by recognising the fallibility of investor decision making.

The implications of extension of Canadian fiduciary obligations to Australian NBFE governance may explain why that territory is so highly contested. Fiduciary duty in Canada is highly distinctive and provides leadership to those in Australia who see fiduciary law as an underpinning of an entrepreneurial wealth creating society.

3.5 United States

3.5.1 Absence of a uniform fiduciary standard

'[T]heir [the proposed SEC] version of the uniform fiduciary standard could also be understood quite differently by various parties.'[411] As in Australia, community expectation and industry practice can be different.

> How to determine, in a positive way, when a person is acting in the best interest of a client is a murky question, to assume that practitioners merely fulfil the strict letter of their legal obligations does not reflect the experiences of many consumers of financial services. Rather, the questions are not new and the problems posed by the ambiguity over proper definition of best interests and the troubles caused by the disclosure mandate that is not meaningful or helpful to an investor are only exacerbated by an expansion of a murky standard.[412]

Some Canadian standards are applied in US judicial interpretations of its statute,[413] but without the holistic regime. US unregistered hedge and private equity funds are not subject to statutory control under the *Investment Company Act* or the *Investment Advisers Act*,[414] an important distinction for

Treatment, Statutory Compliance and Good Corporate Citizenship' (2009–2010) 41 *Ottawa Law Review* 325, 348.

[411] Paglia, above n 102, 9.

[412] Julie A Ragatz, *Duties of Brokers, Dealers, and Investment Advisers* (American College Cary M Maguire Center for Ethics in Financial Services, Letter to the SEC Re: File Number 4-606, in response to release no 34-69013; 1A-3558, 2013) cited in Paglia, above n 102, 9.

[413] *Investment Advisers Act of 1940* (US) 15 USC §§ 206(1)–206(2) (2000).

[414] Henry Ordower, 'The Regulation of Private Equity, Hedge Funds, and State Funds' (2010) 58 *American Journal of Comparative Law* 295.

retail investors and their portfolio advisers. Some advisers have demonstrably not understood the nature of the underlying securities.[415]

US States have different interpretations of fiduciary duty. As a general proposition, broader than those in Australia: Delaware classifies duty of care and good faith as fiduciary alongside loyalty. Some require a surety bond to underwrite the obligations of the fiduciary.

Imposition of strict fiduciary standards in some states does not adversely impact financial service providers. Empirical research finds

> no statistical difference between the two groups[416] in the percentage of lower-income and high-wealth clients, the ability to provide a broad range of [financial] products including those that provide commission compensation, the ability to provide tailored advice, and the cost of compliance.[417]

This is important research for Australia where lobby groups decry high regulatory standards as anti-entrepreneurial. Fiduciary law impacts more than those directly party to the fiduciary relationship. Meeting community expectations is a matter of public interest and can be an outcome of fiduciary law and breaches of it in those relationships.[418]

3.5.2 Common law tradition

Fiduciary obligation has long been recognised in US equity courts.[419] Differently from recent Australian interpretation, US fiduciary duty combines loyalty (a negative posture and minimum standard), care (a positive posture to promote the aims of the principal) and good faith.[420] In the US, 'fiduciary obligation currently operates in the context of common law and federal and state statutes

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[415] Johnston, above n 158, 438.
[416] These two groups were a sample of financial advisers drawn from states with no fiduciary standard and from those with strict fiduciary standards.
[417] Michael S Finker and Thomas Patrick Langdon, 'The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice' (Elsevier, 2012) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2019090>.
[418] Cheryl L Wade, 'Fiduciary Duty and the Public Interest' (2011) 91 *Boston University Law Review* 1191 quoting Tamar T Frankel, *Fiduciary Law* (Oxford University Press, 2011) 52. For a fuller discussion, see Symposium, 'The Role of Fiduciary Law and Trust in the Twenty-First Century: A Conference Inspired by the Work of Tamar Frankel' (Boston University School of Law, 29 October 2010).
[419] Deborah A DeMott, 'Beyond Metaphor: An Analysis of Fiduciary Obligation (1988) *Duke Law Journal* 879, 880 quoted in *Prudent Practices for Investment Managers: Defining a Global Fiduciary Standard of Excellence* (Centre for Fiduciary Excellence LLC and fi360 Inc 112013, Worldwide edition, 2013).
[420] Seaborn Hall, *How to visually illustrate the fiduciary obligation to clients* (Advisor Perspectives, 25 November 2014) 3 citing Arthur B Laby, 'Current Issues in Fiduciary Law — SEC v. Capital Gains Research Bureau and the Investment Advisors Act of 1940' (2011) 91 *Boston University Law Review* 1051, quoting (1989) *MidAmerica v American Express* US Supreme Court 10th Circuit (Scalia J).

but the courts have the final say',[421] there being no agreed source or content of fiduciary law. 'Some have looked to State common law doctrines, such as agency, while others have not'.[422]

US common law fiduciary tradition rests upon personal qualities of conscientious, scrupulous and fastidious behaviours.[423] The quality of:

> not honesty alone but the punctilio of an honor the most sensitive is then the standard of behaviour. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of the courts of equity when petitioned to undermine the rule of undivided loyalty … only thus has the conduct of fiduciaries been kept at a level higher than that trodden by the crowd.[424]

Meinhard, an appeal case, 'continue[s] to shape the modern debate'.[425] It is an absolutist view of fiduciary obligation, not always suited to modern commerce. It is doctrinal suggesting that contracting out of fiduciary duty can be voided in equity. More recent US state law places more emphasis on contract.[426] This is not a unanimous view in the US, some suggesting that trust and self-renouncing fairness relieve participants from monitoring each other, an aspirational standard.[427]

3.5.3 Fiduciary self-regulation

Reliance on common law and lack of a statutory uniform standard has not prevented and may have induced a code of self-regulation consistent with ISO 9000 Quality Management System standards. This culminates in a 'periodic table of global fiduciary practices'.[428] This Global Fiduciary Standard, in stark contrast to Australian statutes, recognises that 'procedural prudence alone does not complete a fiduciary's obligations'.[429] It notes that

> the vast majority of the world's liquid wealth is in the hands of investment fiduciaries and the success or failure of investment fiduciaries can have a material impact on the fiscal health of any country[430] …

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[421] Ibid 2.
[422] Ibid.
[423] Robert B Thompson, *The Story of Meinhard v. Salmon and Fiduciary Duty's Punctilio* (Working Paper Number 08044, Vanderbilt University Law School Public Law and Legal Theory, 2008).
[424] *Meinhard v Salmon* 164 NE 545 (NY 1928) (Cardozo J) cited in Thompson, above n 423, 16.
[425] Ibid 19 quoting Allison Gray Anderson, 'Conflicts of Interest: Efficiency, Fairness, and Corporate Structure' (1978) 25 *University of California Los Angeles Law Review* 738, 760.
[426] In Delaware law, see, eg, *Wood v Baum* 953 A2d 135 (Del 2008) cited in Thompson, above n 423, 27.
[427] Stephen M Bainbridge, *Must Salmon love Meinhard? Agape and Partnership Fiduciary Duties* (Forum on Corporate Governance and Financial Regulation, Harvard Law School, 2013).
[428] *Prudent Practices for Investment Managers*, above n 419. This edition is supported by extensive handbooks and working documents.
[429] Ibid 8.
[430] Ibid 6.

> earning trust is not simply a matter of recent, superior performance, dazzling presentations, or personal relationships: it is a matter of organisational integrity and process driven by prudent practices.[431]

The Global Fiduciary Standard is an attempt to quality assure the investment chain. It encompasses all those statutorily recognised in Federal and State law.[432] It provides a managerial basis for international harmonisation and application of fiduciary principles in the governance of NBFEs.

[431] Ibid 7.
[432] For instance, but not exclusively those providing advice or asset management under the *Investment Advisers Act 1940* (US), *Pension Protection Act 2006* (US), and State securities laws.

4. THE REGULATION OF FINANCIAL ADVICE

4.1 Regulation of Financial Advice in Singapore

Admirable policy did not prevent individual malfeasance within the Singapore subsidiaries of Barings plc in 1995,[433] leading to the demise of that bank and its sale to ING for £1.00.[434] Neither has MAS prevented (together with other agencies), major criminal breaches of trust or a prevalence of fraud on Singapore's larger companies.[435] 'All too often, the current regulatory regime [2009] suffers massive failings and fraud, ruining numerous sundry investors and causing untold suffering [...]'.[436] In the securitisation sector, 'losses were largely borne by investors'.[437]

Losses included, as in other jurisdictions, those arising from debenture issuance.[438] In Australia, these were sold to unknowledgeable wholesale investors, not retail investors as statutorily defined. These products were sold to retail investors[439] in Singapore (7 800 investors invested SGD508 million),[440] and Hong Kong (29 000 investors).[441] The complexity and length of the disclosure documents tested even financially literate institutional investors. 'Worse, the true, substantive nature of the instruments was concealed under hundreds of pages of technical disclosures in order to maximise sales'.[442] Agents of the product distribution system (banks, stockbrokers, advisers, finance companies): 'did not know

[433] *Baring Futures (Singapore) Pte Ltd (in liquidation) v Deloitte & Touche* (a firm) [1997] 3 SLR 312; K Anparasan, 'White Collar Crime in Singapore' (2009) 21 *Singapore Academy of Law Journal* 16, 25.
[434] Anparasan, above n 433, 26.
[435] Ibid 18.
[436] Ibid 34.
[437] Hans Tjio, 'Challenges to Singapore from the Global Financial Crisis: actual and suggested legal and regulatory responses' (2013) *Singapore Journal of Legal Studies* 168.
[438] Financial products sold in Singapore included Lehman Minibonds and DBS High Notes. See Kee Yang Low, 'Product suitability, due diligence, and management responsibility. The New Regime of Regulation 18B of the Financial Advisers Regulations' (2012) 24 *Singapore Academy of Law Journal* 298. In Australia, see, eg, *ABN Amro Bank NV v Bathurst Regional Council* [2014] FCAFC 65 and *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028.
[439] Christopher Chen Chao-Hung, 'Product due diligence and the suitability of minibonds: taking the benefit of hindsight' [2011] *Singapore Journal of Legal Studies* 309, 310.
[440] MAS, *Investigation Report on the Sale and Marketing of Structured Notes linked to Lehman Brothers* (MAS, Report 7 July 2009).
[441] Alan Ewins, 'The Lehman Aftermath: Hong Kong and Singapore Regulatory Reforms in the Structured Products Markets World' (2010) 5(3) *Capital Markets Law Journal* 301.
[442] Tjio, 'Challenges to Singapore from the Global Financial Crisis', above n 437, 172.

what they were selling'.[443] MAS' interpretation of these products suitability ultimately resulted in compensation for retail investors.[444]

Financial advice is regulated.[445] As in Australia, there is no statutory fiduciary obligation to the client. There are ameliorating regulations not found in Australia. Financial advisers are subject to stringent tertiary examination and work experience criteria relevant to the financial products and services they provide.[446] Financial advisers (and senior management) are required to: 'conduct a comprehensive due diligence exercise in order to determine the suitability of a new product before selling it'.[447] Suitability regulation became more onerous in 2011,[448] requiring a financial adviser to perform: 'three categories of due diligence – product due diligence, client due diligence, and … systems due diligence',[449] For retail investors, this is effectively a knowledge test. An adviser must assess: 'the information possessed by him concerning the investment objectives, financial situation and particular needs of the person',[450] clarified by a suitability test. Suitability is not a defined term and can be interpreted as: '"most suitable" or "not unsuitable"',[451] the Singapore preference being for not unsuitable influenced by assessments of risk toleration by the investor. This is a: 'comparative risk'[452] approach requiring executive director participation:

> every member of the senior management [of the financial adviser] must (a) personally satisfy himself that the new product is suitable for the targeted client; and (b) [have] personally approved the sale or marketing of the new product to the targeted client.[453]

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443 MAS, *Investigation Report on the Sale and Marketing of Structured Notes Linked to Lehman Brothers,* above n 440 cited in Tan Sin Liang, 'MAS Investigation Report on the Sale and Marketing of Structured Notes Linked to Lehman Brothers: Where the Financial Institutions went wrong' (2009) *Singapore Law Gazette* 24.
444 *Financial Advisers Act* (Singapore, Cap 110, 2007 rev ed) s 27.
445 Ibid.
446 Ibid Minimum Entry and Examination Requirements for Representatives of Licensed Financial Advisers and Exempt Financial Advisers, s 23B(3).
447 Low, above n 438; see also Tjio, 'Challenges to Singapore from the Global Financial Crisis', above n 437, 175.
448 Low, above n 438.
449 Ibid 304.
450 *Financial Advisers Act* (Singapore, Cap 110 2007 rev ed) s 27(1).
451 Chao-Hung, above n 439, 315.
452 Ibid 316.
453 *Financial Advisers (Amendment) Regulations* 2011 (Singapore, Cap 110, Rg 2, 2004 rev ed) s 18B; See Low, above n 438, 304.

The personal accountability of these onerous statutory requirements cannot be delegated and are not consistent with director company law responsibility[454] or with other statutory provisions.[455] Consequently, there is: 'genuine doubt',[456] as to the practicality of this regulation.

International Organisation of Securities Commission (IOSCO) principles govern financial intermediaries.[457] MAS may exempt advisers from these requirements when dealing with High Net Worth Individuals (HNWI).[458] HNWI advisers may also insert non-reliance clauses into client agreements. This shields them from claims for negligence, breach of representation, fiduciary and contractual duties.[459] Advisers are under statutory duties not to make false or misleading statements with the intent to deceive, to disclose any matter germane to the statement,[460] and not to make recommendations without reasonable basis.[461] There are no express statutory civil liabilities for these offences, but the statutory standards may be useful in general law claims,[462] unless there is a non-reliance clause.[463]

4.2 Regulation of Financial Advice in Germany and the EU

German law provides insights into the future for Australian investors and regulators. For demographic reasons, German investors are now treated as major consumers of financial products and services for self-sufficiency. In Australia, with the exception of consumer credit and superannuation default funds, investors are often treated as capital providers rather than consumers.[464] Australia has yet to withdraw from financing public welfare.

Traditionally, German regulation was not market oriented. '[C]onsumer protection should be a fundamental political and legal priority for national and [EU] Community legislators; such protection cannot be left to the automatic operation of single market mechanisms'.[465] The German NBFE capital

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[454] *Companies Act* 2006 (Singapore, Cap 50 2006 rev ed) s 157C.
[455] *Financial Advisers Act* (Singapore, Cap 110 2007 rev ed) s 27.
[456] Low, above n 438, 309.
[457] MAS, *Supervision of Financial Market Infrastructures in Singapore* (MAS Monograph 4, 2013 rev January 2015).
[458] *Financial Advisers Act* (Singapore, Cap 110, 2007 rev ed) s 58.
[459] Poh Chu Chai, 'Banking Law' (2012) 13 *Singapore Academy of Law Journal Annual Review of Singapore Cases* 75, 76.
[460] *Financial Advisers Act* (Singapore, Cap 110, 2007 rev ed) s 26.
[461] Ibid s 27.
[462] Chai, above n 459, 56.
[463] *Orient Centre Investments v Societe Generale* [2007] 3 SLR 566.
[464] See, eg, Dimity Kingsford Smith, 'ASIC Regulation for the investor as consumer' (2011) 29 *Companies and Securities Law Journal* 327.
[465] Ibid 348.

market opportunities for retail investors during this period, including for D-REITS was limited. German investors often invested in NBFEs domiciled in other jurisdictions.

Policy reversed in 2004[466] to emphasise: 'choice, competition, and the lessening of regulatory burdens in developing an EU concept of retail protection',[467] the twin pillars[468] of EU retail investor strategy. This 'represents a bold attempt to build a pan-EU retail investor culture, relying on the transformative effects of law'.[469] It was a fundamental policy change. In essence emulating Australian Wallis reform policy.[470]

The MiFID reforms reflected: 'an international policy concern with individual financial literacy and independence, with promoting greater diversity in personal savings mechanisms to support personal pension provision…'[471] Financial advice became 'increasingly important',[472] 'emerging strongly as a key market gateway and distribution channel'.[473] These reforms, part of the EU Financial Services Action Plan (FSAP) were intended to create a pan-EU capital market, with retail investors serving as capital providers. This was the antithesis of post-war paternalism. It emulated US (and Australian) market concepts: 'the "trusting" retail investor is the heart and soul of the huge US market and should be supported'.[474] There is no consistent underlying theory,[475] and as in Australia, ongoing debate between proponents of lighter regulation (efficient markets) and more regulation (paternalism), based in behavioural economics.[476] German reform, as in other EU countries, followed the Lamfalussy

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466 *Directive 2004/39/EC of the European Parliament and of the Council on Markets in Financial Instruments (MiFID of April 21, 2004)* [2004] 39/EC OJ 2004L 145/1.
467 Niamh Moloney, 'Building a Retail Investment Culture through Law: The 2004 Markets in Financial Instruments Directive' (2005) 6 *European Business Organisation Law Review* 354, 349.
468 Ibid 383.
469 Ibid 342.
470 S Wallis, *Australian Financial System Inquiry Final Report* (Australian Government Publishing Service, March 1997) ['Wallis' or 'Wallis Report'].
471 Moloney, 'Building a Retail Investment Culture through Law', above n 467, 345.
472 Ibid 347.
473 Ibid.
474 L Stout, *The investor Confidence Game* (UCLA School of Law Research Paper No 02–18, 2002) 35; See also Moloney, 'Building a Retail Investment Culture through Law', above n 467, 346.
475 Moloney, 'Building a Retail Investment Culture through Law', above n 467, 370.
476 G Mitchell, 'Why Law and Economics' Perfect Rationality should not be traded for Behavioural Law and Economics' Equal Incompetence' (2002) 91 *Georgetown Law Journal* 67.

process of delegated legal implementation,[477] other than distance marketing (online marketing) where member state discretion is eliminated.[478]

EU law reform of retail investor capital markets was estimated to increase EU GDP by 'between 0.5 and 0.7% [pa].'[479] Most of this investment is in NBFEs structured as collective investment schemes (CIS), estimated to be in excess of 4 trillion euros and 40 per cent of EU GDP.[480] Law reform led to c 40 000 UCITS[481] compliant funds available for investment[482] (CIS and mutual funds).

The liberalisation of the capital markets led directly to:

> a wave of investor lawsuits of hitherto unimaginable proportions [which] shed a clear light on the mistakes on the part of issuers and advisory companies, and on the bad performance of the investment products.[483]

Some financial products which typically should not have been issued as UCITS compliant included Lehman Brothers securities. Loss of trust and falls in risk tolerance are 'unlikely to be short-lived … likely to be enduring and will be very slow to recover'.[484] In Austria and Germany, often involving Lehman Brothers securities, 'more than 11,000 proceedings[485] … more than 22,500 claims have been asserted'.[486] Within the EU, prospectuses can be issued in English for any national jurisdiction and consent to its issuance provided by any national authority. Approval for the issuance of the Lehman Brothers securities was given by the Irish Securities Authority, with only a notification to the national (Austrian) Financial Markets Authority (*Finanzmarktaufsicht*). Many of these compensation claims related to alleged liability of representations made in marketing collateral.

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[477] Alexandre Lamfalussy, *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets* (Brussels, 2001).
[478] Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC(14) [2002] OJ L 65 271/16.
[479] Friedrich Heinemann and Mathias Jopp, *The benefits of a Working European Retail Market for Financial Services* (Report to the European Financial Services Round Table, Institute für Europäische Politik, Berlin, 2002); See generally Niamh Moloney, 'Building a Retail Investment Culture through Law: The 2004 Markets in Financial Instruments Directive' (2005) 6 *European Business Organisation Law Review* 341, 354 citing Heinemann and Jopp, above.
[480] Moloney, 'Building a Retail Investment Culture through Law', above n 467, 358.
[481] Undertakings for Collective Investment in Transferable Securities.
[482] Niamh Moloney, 'The Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?' (2012) 13 *European Business Organisation Law Review* 169, 176.
[483] Kalss, 'Civil Law Protection of Investors in Austria', above n 151, 212.
[484] Guiso, above n 150, 209.
[485] Kalss, 'Civil Law Protection of Investors in Austria', above n 151, 212.
[486] Ibid.

A best interest requirement inevitably requires an assessment of suitability for specific client advice and, as in other jurisdictions, know-your-client processes. Under the MiFID business conduct regime, there is a distinction between suitability and appropriateness, depending on context including investor/adviser asymmetries, the tests being proactive and individualised,[487] and which test the efficacy of the disclosure requirements. MiFID implementation into German law required legislative amendment[488] for businesses providing 'investment services on a commercial basis'.[489] For the first time, distinctions were made between professional and retail advisory clients. As in Australia, local authorities were categorised as professional investors (constitutionally disputed)[490] even if their investment competencies were of retail standard.

Agency or mandate agreements (*Geschäftsbesorgnung*) can have contractual fiduciary obligations regulated by the *Civil Code*.[491]

> Whoever is obliged to undertake independent economic activity in third-party interest in promoting and protecting the economic interests of his contractual partner, he has by virtue of his decision-making power given to him and the discretion he is to exercise a particular relationship of trust and … special loyalty.[492]

The MiFID regime, designed to be preventive, is supported in German speaking countries by substantive civil law and commercial practices fiduciary law applied ex post with injunctive and compensatory remedies.

> The informed investor decision [*culpa in contrahendo*] is the end of European securities regulation in two senses: it is the objective and the boundary of regulation. Once retail investors take investment decisions, these decisions are not further questioned by the law,[493]

provided client best interest requirement has been honoured in accordance with their fiduciary relationship.[494]

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[487] Moloney, 'Building a Retail Investment Culture through Law', above n 467, 406.
[488] *Securities Trading Act* (Germany) 1998 ('WpHG') § 2 s 4.
[489] Barry and Bracht, above n 232, 1178.
[490] Ibid 1181.
[491] Allen, above n 249, 75.
[492] Ibid 76.
[493] Lars Klöhn, 'Preventing Excessive Retail Investor Trading under MiFID: A Behavioural Law & Economics Perspective' (2009) 10 *European Business Organisation Law Review* 437, 439.
[494] *Directive 2004/39/EC of the European Parliament and of the Council on Markets in Financial Instruments (MiFID of April 21, 2004)* [2004] 39, art 19(4).

4.3 Regulation of Financial Advice in the United Kingdom

There is a distinction between independent advice and restricted advice but it does not directly follow the US typology of broker-dealers and investment advisers or the Australian typology of general or specific advice. Two distinguishing features are between fiduciaries providing investment advice and product sellers, traditionally commission based with 'no statutory duty imposed on investment advisers in the UK to act in the best interest of their clients'.[495] FCA regulatory guidance also includes conflicts of interest and know your client rules.[496] Statutory support of FCA regulatory guidance[497] 'allow[s] actions to be brought for breaches of the FCA Principles for Business, including the requirement that a "firm must pay due regard to the interests of its customers and treat them fairly"'.[498]

4.4 Regulation of Financial Advice in Canada

The provision of financial advice and wealth management services by SROs in Canada is distinctive and provides important reform insights. There is no safe harbour defence for the adviser as there is in Australia.

The Canadian Client Relationship Model (CRM) model provides useful and consistent insight for Australia in its search for what best interest means to a client in practice. CRM is enforced through SROs. It includes Canadian statutory and common law duty of care standards. Disclosure, misleading conduct, disclosure of material conflicts of interest,[499] reasonable prudence, recklessness and obligation to investigate,[500] lying,[501] overstating asset values,[502] excessive undisclosed leverage[503] are automatically included in the duty of care in the CRM.[504] It includes fiduciary and non-fiduciary relationships 'with respect to all matters applicable to so called "best interest" standards.'[505]

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[495] Paglia, above n 102, 20.
[496] *Conduct of Business Sourcebook*, above n 345, [1]–[22].
[497] *Financial Services and Markets Act 2000* (UK) s 138D.
[498] *Principles of Business* (Financial Conduct Authority UK) 2.1.1R cited in *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 315, [11 146].
[499] *SEC v Capital Gains Research Bureau, Inc* (1963) 375 US 180.
[500] *Raymond J Lucia Companies, Inc and Raymond J Lucia Sr* (2013) SEC Release no ID-495, 2013 WL 3379719.
[501] *SEC v Chase* (2011) WL 6176209 FSLR P 96614.
[502] *Warwick Capital Management Inc and Carl Lawrence* (2008) SEC Release no 1A-2694.
[503] *United States v Lay*, 566 FSupp 2d 652, 655-68 (ND Ohio 2008).
[504] Paglia, above n 102, 18.
[505] Ibid 14.

Canada has a principles-based interpretation of the nature and scope of fiduciary obligations in financial advice. Traditional typologies based on the status of relationships or of facts have become considerably extended through the adoption of its CRM.

4.5 Regulation of Financial Advice in the United States

US consumers of financial products and services have suffered greatly from avoidable systemic failures in the country's regulatory systems. Some 9.5 million families lost their homes, 'nearly USD 11 trillion in household wealth has vanished, with retirement accounts and life savings swept away.'[506] Much of this was inflicted by the 'shadow banking' system (US NBFEs).

> Widespread failures in financial regulation and supervision proved devastating to the stability of the nations['] financial markets. Policymakers and regulators failed in their responsibilities to protect the public… [507]

Investment advisers are fiduciaries who owe their retail clients a duty of care and must act in their client's best interest. A broker dealer is subject to a lower suitability standard for their personalised advice, which is a lesser standard than Canadian SROs apply and a lesser standard than for Australian superannuation trustees. Best interest means the best option for the client.[508] Suitability is not a fiduciary standard. Standards become more complex for pension investments where all financial intermediaries advising on tax advantaged retirement funds have fiduciary responsibilities from 2017.[509] 'These divergent standards are not necessarily evident to the average investor',[510] who may not be aware of the differing duties arising under the regulatory infrastructure and differing financial incentives in client relationships.

The need for trusted financial intermediaries who cannot abuse asymmetry of technical knowledge led the SEC to propose a 'uniform fiduciary standard',[511] based on contested judicial definition of investment advisers as fiduciaries,[512] and reflecting community expectations of how a financial adviser should behave, no matter what the regulatory overlay, and the investor protection intent of the US Congress. This standard is to be 'no less stringent than the standard applicable to investment

[506] Symposium, above n 154, citing Born, above n 154, 1.
[507] Ibid citing Born, above n 154, 2.
[508] Demina, above n 121, 439.
[509] Employee Benefits Security Administration Department of Labour (US).
[510] Demina, above n 121.
[511] Ibid 443. This proposal faces continued delay.
[512] *SEC v Capital Gains Research Bureau, Inc* 375 US 180, 184–185 (1963) cited in Laby, above n 420, 1051.

advisers … when providing personalised investment advice about securities'.[513] Some opine that 'standards should be based on analogous trust law concepts',[514] and trust law should 'inform the best interest standard',[515] being in the entrustor's sole interest.[516]

4.5.1 Best interest

Best interest duties in the US, as in Australia are:

> highly ambiguous,[517] leaving significant practical questions unanswered, and investment advisers and their clients left to 'divine, if not guess, the application in everyday business life of basic fiduciary obligations, such as the duty to provide impartial advice.[518]

This ambiguity consumes 66 000 words.[519] Duties of financial advisers, however termed, in the US, are not necessarily fiduciary in nature and should only apply 'where there is a broad delegation of power to manage another's property...'[520] Describing non-fiduciary duties as part of the uniform fiduciary standard has only served ambiguity and those that prosper from it. In Canada, these operate concurrently within the Client Relationship Model which provides for the alignment of fiduciary duty with the client engagement contract. In the US, a client engagement contract is mandatory with an alignment of fiduciary duty with the scope of engagement.[521]

Further legal uncertainty in financial services provision and advice is likely, including proposed statutory reform or repeal.[522]

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[513] *Investment Advisers Act of 1940* (US) 15 USC §§ 206(1)–(2) (2000) cited in Paglia, above n 102, 8.
[514] Nicholas S Di Lorenzo, 'Defining a New Punctilio of an Honour: The Best Interest Standard for Broker-Dealers' (2012) 92 *Boston University Law Review* 291, 292.
[515] Ibid 314.
[516] *Uniform Trust Code 2000* (US) § 802(a) followed in 2005 by 14 states and Washington DC cited in Di Lorenzo, above n 514, 315.
[517] Paglia, above n 102, 19 citing Laby, above n 420.
[518] Ibid citing Barry P Barbash and Jai Massari, 'The Investment Advisers Act of 1940: Regulation by Accretion' (2008) 39 *Rutgers Law Journal* 627 [654].
[519] Alan Kohler, 'Trump rolls back uncertainty', *The Australian* (Sydney), 7 February 2017.
[520] Larry E Ribstein, 'Fencing Fiduciary Duties' (2011) 91 *Boston University Law Review* 899, 919.
[521] Knut A Rostad, *Re: Rule Making – Duties of Brokers, Dealers, and Investment Advisers* (Letter to the SEC, The Institute for the Fiduciary Standard, 2013) cited in Paglia, above n 102, 16.
[522] *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* (US), USC Public Law No 111–203.

5. RELATED PARTY TRANSACTIONS AND CONFLICTS OF INTEREST

Empirical analysis[523] attributes systemic failure in Australian NBFE regulation to director malfeasance associated with related party transactions. In some professions, but not NBFEs, Australia prohibits RPTs: for example a medical practitioner in general practice cannot own a radiology or pathology business. RPTs occur globally.[524] RPTs can be an effective mechanism, shrouded in legitimacy, to 'divert value from a corporation'.[525] Different jurisdictions have addressed this issue in different ways. More broadly:

> Conflicts of interest where there are not related party transactions, but which have similar outcomes, are categorised as 'tunnelling', being the 'transfer of resources out of a company [or other entity] to its controlling shareholder … [by] dominant shareholders and managers.[526]

Examples include situations where the company is not a related party but lead to a change of control. Related party law and associated accounting standards[527] require proximity between the parties. Tunnelling does not. Neither do value transfers, only resource or asset transfers or the transfer of legal rights.

> Laxity in regulation and enforcement of anti-tunnelling provisions has traditionally been common around the world. This is tantamount to an implicit legalisation of pecuniary private benefits extraction. No disclosure regime can be expected to succeed in forcing dominant shareholders to confess how much they are stealing from their controlled company.[528]

Can RPTs be in the best interest of the company? How is this to be disclosed, analysed and legally enforced? Transactional disclosure of itself is not sufficient to determine best interest even under a common definition of best interest, as in Germany, unlike Australia with its multiple definitions. Statutory disclosure requires materiality directly related to that transaction. Transactional statutory disclosure does not require disclosure of long term strategic intent. This laxity in regulation via RPTs and tunnelling leads directly to creeping corruption. It arises from the distinction between value and interests or rights as statutorily or contractually determined without regard to fiduciary or other equitable principles.

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[523] See above ch 3, author's empirical analysis of Australian senior court NBFE cases 1981–2018.
[524] Enriques, above n 218.
[525] Ibid 2.
[526] Ibid 3.
[527] *International Financial Reporting Standards* (International Accounting Standard No 24).
[528] Enriques, above n 218, 8.

Related party transactions are regulated using a number of legal tools, of varying efficacy and depend on the efficiency of enforcement. Prohibition of some transactions, including related party loans and loan guarantees would be effective in some Australian creeping corruption cases, but may not be in the best interest of the company when the related party is the only willing participant. Selective prohibitions including 'loans to related parties such as directors and executives have traditionally been more common in Europe and gained traction in the US and China in the first half of the 2000's,'[529] may be more pragmatic than a total prohibition. The reverse requires prohibition in Australia: loans by a related party to the company which are known to change control and shift value. Shareholder approval for a specific transaction easily leads to transfer of value and loss of control since only specific transactional approval is required, not its long term value impact approval.

5.1 Singapore

Directors entering into sham contracts and unauthorised payments even if for the purported benefit of the company are not in the interests of the company. Neither are diversion of funds from the company to a director,[530] a related party of a director,[531] or appropriation of commercial opportunities by a director.[532] Directors are required to make full disclosure to their fellow directors and to the extent there may be a breach by a fiduciary, are required to obtain 'informed consent'.[533] Informed consent includes all of a company's shareholders.[534] Such breaches of fiduciary duty constituting breaches of trust may result in the director becoming a constructive trustee[535] and, 'no period of limitation shall apply to an action by a beneficiary under a trust "in respect of any fraud or fraudulent breach of trust"'.[536] Fiduciary responsibility extends to senior employees.[537] Singapore has a: 'strict and clear approach towards fiduciaries who must account for profits made without permission from the company… '[538] Ultimately, all rests on disclosure uncertainties.

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529 Ibid 14.

530 Tan Cheng Han, 'Company Law' (2007) 8 *Singapore Academy of Law Journal Annual Review of Singapore Cases* 126.

531 *Panweld Trading Pte Ltd v Yong Kheng Leong* [2012] 2 SLR 672 (Chong J).

532 Tan Cheng Han, 'Company Law' (2008) 9 *Singapore Academy of Law Journal Annual Review of Singapore Cases*. 175, 177.

533 *Lim Suat Hua v Singapore Health Partners Pte Ltd* [2012] 2 SLR 805 (Ang J).

534 *Yong Kheng Leong v Panweld Trading Pte Ltd* [2013] 1 SLR 173.

535 *ECRC Land Pte Ltd v Ho Wing On Christopher* [2004] 1 SLR 105.

536 *Limitations Act* (Singapore, Cap 163, 1996 rev ed) s 22; *Dynasty Line Ltd v Sia Sukamto* [2014] 3 SLR 277.

537 *ABB Holdings Pte Ltd v Sher Hock Guan Charles* [2009] 4 SLR (R) 111 (Prakash J).

538 Dan W Puchniak and Tan Cheng Han, 'Company Law' (2013) 14 *Singapore Academy of Law Journal Annual Review of Singapore Cases* 179 [9.14] citing *Mona Computer Systems (S) Pte Ltd v Singaravelu Murugan* [2014] 1 SLR 847.

5.2 Germany and the EU

Conflicts of interest and fidelity are regulated under civil law fiduciary-like principles of *untreue* and *culpa in contrahendo* as well as statute. Fiduciary obligations 'can be relied on where the [statutory] rules of on directors' duties do not address a particular conflict'.[539] These include conflicts of economic interest derived from related party transactions and wrongful exploitation of corporate opportunity. Australian statutes subsume general law fiduciary principles, proscribe fiduciary obligations, and strictly limit the definition of a fiduciary. This is not so in Germany with its civil law obligations. Statutory interpretation of loyalty is narrowly defined to mean actual, not potential competition 'within the scope of the company's business'.[540] German law balances this narrow statutory definition with 'an unwritten duty of loyalty'[541] applied where the statute does not. Judicial innovation evolves the law although 'authoritative case law is rare'.[542]

To Australian eyes, traditionally limited statutory intervention may seem odd. It is the primacy of fiduciary-intent obligation and the two-tier corporate governance system that ensures Australian-style prescriptive statutory interventions are not required in Germany. The governance system diffuses decision making power,[543] enabling more supervision of related party transactions.

Most EU jurisdictions have procedural rules governing the disclosure of related party transactions. These are statutorily narrowly applied in Germany by the *Stock Corporation Act* specifically to a director entering into related party transactions where that director is both beneficiary and decision maker.[544] There is a statutory duty of care but no duty to avoid conflicts of interest.[545] In other jurisdictions, reliance on procedure includes 'a majority of the minority',[546] and/or independent director exercising business judgment,[547] or 'expert opinion',[548] approval. All are problematic since all rely on the company directors to provide the necessary information. Limited financial resources provided to directors to assess materiality in its context and complex disclosure documentation 'naturally favour opacity'.[549] Proposed EU harmonisation of related party transactions regulation is

539 Gerner-Beuerle and Schuster, above n 247, 207.
540 *Stock Corporation Act* (Germany) 1965 ('AktG') § 88(1); Gerner-Beuerle and Schuster, above n 247, 211.
541 Gerner-Beuerle and Schuster, above n 247, 211.
542 Jansen, above n 244, 1492; Gerner-Beuerle and Schuster, above n 247, 214.
543 *Stock Corporation Act* (Germany) 1965 (('AktG') §§ 93(1), 112.
544 *Stock Corporation Act* (Germany) 1965 ('AktG') § 112.
545 Ibid § 93(1); Gerner-Beuerle and Schuster, above n 247, 198.
546 Enriques, above n 218, 15.
547 Ibid 18.
548 Ibid 22.
549 Ibid.

likely only to favour laxness since the differing jurisdictions operate very differently. Director independence in Germany is something of a compromise: 'a substantial and not merely temporary conflict of interests',[550] including controlling shareholder related parties. 'There is no universal definition of "independence"'.[551] German law 'only vaguely requires the supervisory board to include "what it considers an adequate number of independent members"'.[552]

EC regulation of CRAs has moved from its voluntary comply-or-explain mode to registration and supervision, nationally based, given their central role in the financial system and their contribution to its systemic failure globally.[553] One objective is to remove conflicts of interest between adviser to the rated entity and publisher of the credit quality of client securities.[554] This conflict has been evident in Australian NBFEs where the supposedly independent research house has a related party investment manager which it recommends.

5.3 United Kingdom

Fiduciary obligation is the mirror of community expectation of those that advise them or manage their funds. As in the EU, the UK has adopted a number of approaches to the regulation of related party transactions with some confusion. '[M]uch of this confusion arises because of ignorance of the complex history of this area of the law and the principles and policies underpinning that law.'[555] Fiduciaries (directors and trustees) should not be 'held accountable through the unreasonable and inequitable application of equitable principles.'[556] Traditional judicial interpretation[557] conflicts with present statutory formulation,[558] requiring 'a more precise analysis of whether there is a real conflict as opposed to a real possible conflict before finding the director in breach of duty.'[559] In contrast the UK has long eliminated fiduciary general law as the basis for insider trading enforcement.[560]

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[550] Ringe, above n 251, 411 citing German Corporate Governance Code (2013).
[551] Ibid 414.
[552] Ibid 418.
[553] *Regulation (EC) No 1060/2009 Of The European Parliament And Of The Council of 16 September 2009 on credit rating agencies* OJ 2009 L 302/1.
[554] MacNeil, above n 276, 506.
[555] John H Farrar and Susan Watson, 'Self-Dealing, Fair Dealing, and Related Party Transactions — History, Policy and Reform' (2011) 11(2) *Journal of Corporate Law Studies* 495.
[556] *Boardman v Phipps* [1967] 2 AC 46 [133]–[134] cited in Hannigan, 'Reconfiguring the No Conflict Rule', above n 371, 742.
[557] *Parker v McKenna* (1874) 10 AC 96 [124]–[125].
[558] *Companies Act 2006* (UK) ss 175(1)–(2).
[559] Hannigan, 'Reconfiguring the No Conflict Rule', above n 371, 743.
[560] Loke, 'From the Fiduciary Theory to Information Abuse', above n 206, 138–43.

EU regulation of related party transactions, recognising they may have potential value, has not pursued the prohibition philosophy, and provides for business judgment. The UK has also introduced subjectivity, rather than the strict traditional judicial approach,[561] by widening director statutory responsibility to company long term success. The '[c]orporate benefit doctrine has not been developed in English law. This is another example of the uncertainty created by these reform, and the complex and confused policies which lie behind them'.[562] Disclosure, including the nature of the related party interest not just its existence, and prior fully informed consent of the disinterested members of the company form the basis of modern UK related party transaction governance.[563]

Corporate opportunity is a problem for investment managers, especially in portfolio based venture, private equity and hedge funds. Their underlying investment base will normally have common directors, under the UK statute, of potentially competing investees. The UK judicial typology of strict (inflexible) which categorises anything of economic value as the company's opportunity, or flexible (fact and context based) interpretations of corporate opportunity has not been resolved by statute. Rather, it emulates strict judicial tradition, it being 'immaterial whether the company could take advantage of the proper, information, or opportunity'.[564] There is a reasonableness test,[565] but this is constrained without judicial guidance,[566] previously applying different phraseology.[567] *Could* requiring no overt action by the company, is different from *would* which does require a positive action. The UK statute can stifle NBFE entrepreneurship without meeting its legislative objective of simplifying the law. It is harsh: in any event its codification requires judicial interpretation who also have a statutory duty to apply previously existing general law. That interpretation will define the veracity and legislative future of s 175(4)(b).

5.4 Canada

Canadian conflict of interest regulation extends beyond Australian proscriptive tradition requiring consideration of whether a conflict may be 'expect[ed] to arise between the firm including each individual acting on behalf of the firm and its client'.[568] Disclosure of itself is not sufficient. There

[561] *Aberdeen Railway Co v Blaikie Bros* (1854) [1843]–[1860] All ER 249 cited in Farrar and Watson, above n 555, 505.
[562] Farrar and Watson, above n 555, 506; *Companies Act 2006* (UK) s 172.
[563] *Companies Act 2006* (UK) s 200.
[564] Ibid s 175(2).
[565] Ibid s 175(4)(b): 'The duty is not infringed if the situation cannot be reasonably be regarded as likely to give rise to a conflict of interest'.
[566] Ernest Lim, 'Directors' Fiduciary Duties: A New Analytical Framework' (2013) 129 *Law Quarterly Review* 242 <http://papers.ssrn.com/sol13/papers.cfm?abstract_id2368147> 4.
[567] See *Boardman v Phipps* [1967] 2 AC 46 cited in Lim, above n 566, 7.
[568] Canadian Securities Authority, *National Instrument No 31-103CP*, pt 13.4.

must be a proactive business system of identifying conflicts of interest with prospective clients by the firm and participants in it, 'consistent with the best interests of the client'.[569] 'T]he exercise of business judgment influenced only by the best interest of the client…[570] Canadian investment advisers do not have business judgment protections accorded directors of Canadian companies.

5.5 United States

The US fair value approach Australia has been adopted in Australia. Of itself this is problematic and ignores the fiduciary obligation of not serving more than one master and obtaining the 'best bargain possible.'[571] Independent experts are not necessarily truly independent (financially or otherwise), competent to advise on value creation through corporate strategy, and focus on short term transactional analysis.

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[569] Investment Industry Regulatory Organisation of Canada, *Approved Person responsibility to address conflicts of interest Rule, 42.2*.
[570] The Mutual Fund Dealers Association of Canada, *Rule 2.1.4*.
[571] Farrar and Watson, above n 555, 520.

6. DISCLOSURE

6.1 Singapore

Singapore included consumer protection provisions for all financial products in 2009.[572] Suitability cannot be a mere assessment of individual circumstances where: 'there is no authority to suggest the law should be more generous to retail investors'.[573] The sale of some of these products to retail investors where:

> [C]ontractual documentation … consists of more than 500 pages … make it easier to understand why senior banking figures … had little understanding of this market and of the risks their institutions were undertaking.[574] This observation is alarming for retail investors.[575]

Singapore's response was to require a Pricing Statement and Product Highlights Sheet as a supplement to the Base Prospectus. 'Does suitable documentation exist at all'?[576] More accurately, can suitable documentation exist at all for retail investors? Would these recurring multi-jurisdictional disclosure problems be resolved by merit based or prohibition based regulation? 'In fact, disclosure alone has never been enough in the case of unit trusts that are regulated as collective investment schemes ...'[577]

Disclosure is meant to: 'encourage[s] innovation and facilitate[s] the development of a more sophisticated body of consumers',[578] since disclosure is, 'meaningless if consumers do not know how to make use of disclosed information in making financial decisions'.[579] Objective disclosure is measured by a 'reasonable investor'[580] standard. Retail investor protection relies on 'fair dealing'.[581] These investor protections are not the same as those in Australia. In addition, for debentures issued by collective investment schemes (CIS), a trustee is required for the duration of the debenture.[582]

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572 *Consumer Protection (Fair Trading Act)* (Singapore, Cap 52A, 2009 rev ed). Financial product suitability for Australian retail investors lags such stringency except eligibility for consumer credit. See, eg, Gail Pearson, 'Reading Suitability against Fitness for Purpose — the Evolution of a Rule' [2010] 1 *Singapore Journal of Legal Studies* 129, 146.
573 Chao-Hung, above n 439, 326.
574 *UBS AG v HSH Nordbank AG* [2009] EWCA Civ 585 [2].
575 Chao-Hung, above n 439, 322.
576 Ibid.
577 Tjio, 'Challenges to Singapore from the Global Financial Crisis', above n 437, 176.
578 MAS, *Objectives and Principles of Financial Supervision in Singapore*, above n 4, Principle 9 [4.15].
579 Ibid Principle 10 [4.16].
580 *Securities and Futures Act* (Singapore, cap 289) s 243.
581 *Consumer Protection (Fair Trading) Act* (Singapore, Cap 52A rev ed, Act 15 of 2008).
582 Tjio, 'Challenges to Singapore from the Global Financial Crisis', above n 437, 174.

Singapore requires MAS approval for a collective investment scheme and its trustee, a higher standard than the registration requirement in Australia. Cultural factors are also different:

> although a disclosure-based philosophy was embraced by the state, the lack of private enforcement, and perhaps cultural apathy towards transparency, alongside a pool of relatively unsophisticated, elderly investors, made this a dangerous mix.[583]

Singapore does not follow comparable IOSCO principles on investor protection.[584] Despite personal suitability obligations, there is still emphasis on caveat emptor to encourage investors to become financially literate. Otherwise, Singapore investors rely on statutory interventions, and fiduciary relationships, if any. Other differences include the source of disclosure provisions. Singapore, albeit with departure,[585] follows prevailing English law, whereas Australia follows the US and its reliance on unconscionability in trading.[586] There is no precise definition of unconscionability and a: 'high threshold in establishing a strong prima facie case of unconscionable conduct'.[587]

There are cultural reasons for the 'lack of private enforcement, despite statutory rights of action. Statutory intervention into misleading disclosures in securities offer documentation has a long legacy[588] including in Singapore,[589] now with enhanced investor statutory protection.

> More than that, the interaction between the mandatory disclosure regime and the statutory right to damages for misleading prospectuses results in investors having a legally enforceable right to an increased range of information.[590]

This intervention extended the previous general law provisions by requiring disclosure of all material facts required by an investor to make an informed decision. Consistency with other elements of Singapore law is achieved by the extension of potential liability to all 'intermediaries who have critical responsibility as "gatekeepers" of securities offerings…'[591] reflecting UK fiduciary proposals and German civil law practice.

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583 Ibid 175.
584 Ibid 181.
585 Chai, above n 459, 94.
586 *Australian Securities and Investment Commissions Act 2001* (Cth) s 991A(1).
587 Chai, above n 459, 84.
588 *Directors Liability Act 1890* (UK); *Financial Services Act 1986* (UK) s 150; *Ontario: Securities Act RSO 1990* (Canada); *Financial Services and Markets Act 2000* (UK) s 90; *Corporations Act 2001* (Cth) ss 728–729.
589 *Securities and Futures Act* (Singapore, Cap 289, 2016) s 254.
590 Ibid s 243; See generally Alexander F H Loke, 'The efficacy of securities investors rights in Singapore' (2009) *Singapore Journal of Legal Studies* 114.
591 Loke, 'The efficacy of securities investors rights in Singapore', above n 591, 116.

Whilst these provisions refer specifically to securities offered pursuant to a prospectus for SGX listing purposes, they extend to NBFE securities.[592] There were 'at least five different entities associated with Lehman Brothers group involved with Minibond Series 9, enabling Lehman Brothers to earn various fees'.[593] However: 'Investors' compensatory rights are strongest where there is an offer of securities requiring preparation of a prospectus'.[594]

Singapore statutory intervention has not followed the UK or Australia which now do not require contractual rescission by the investor.[595] Singapore requires only proof of the inaccuracy of a statement, not that it was fraudulent or negligent, or that it was intended the investor rely on the statement and did so, a lesser test than in general law. Professional advisers are not presently regarded as intermediaries for the purposes of disclosure liability, as they are in the US.[596] 'The current regulatory framework in Singapore does not provide the necessary incentives for lawyers to make all of the relevant inquiries advising on their clients' disclosure documents'.[597] Verification practice is the responsibility of the issuer rather than professional advisers. There have been a: 'recent spate of scandals relating to outright fraud and disclosure failures ...'[598] in Singapore listed company prospectuses.

> There is a lack of objective due diligence standards which lawyers are expected to meet when they are advising on public disclosure documents.[599] There is a similar lack of objective standards of due diligence … for … other non-prospectus disclosure documents.[600]

For unlisted NBFEs, failures in disclosure are more difficult to identify. Documentation complexity and lack of standards or adviser liability in due diligence add risk to Singapore NBFE investments.

6.2 Germany and the EU

Specific EU disclosure reforms include extension of the MiFID advice and distribution regime to other financial products (Packaged Retail Investment Products). Standardised Key Investor

[592] Intermediaries may include inter alia the Promoter, Issuer, Trustee, Swap Counterparty, Guarantor, Reference Entities, Corporate adviser, Investment Manager, Calculation Agent, Collateral providers, Arranger, Distributor, Financial Adviser, Payment Agents, and Custodian.
[593] Chao-Hung, above n 439, 313.
[594] Loke, 'The efficacy of securities investors rights in Singapore', above n 591, 133.
[595] Ibid 128.
[596] *Sarbanes-Oxley Act* (US) Pub L 107–204 § 307.
[597] Wai Yee Wan, 'The responsibilities of lawyers for their clients' misstatements and omissions to the securities markets in Singapore' (2014) *26 Singapore Academy of Law Journal* 137, 167.
[598] Ibid 146.
[599] Ibid 137.
[600] Ibid 148.

Information Documents extended UCITS compliance to other financial products, limitations on product selling without financial advice, restrictions on conflicted remuneration (MiFID 11/MiFIR from January 2018),[601] ex ante product intervention powers, ex post product prohibition powers, and collective redress (ie Representative or Class Actions). '[R]egulators in Europe are practically falling over themselves to demonstrate their commitment to protecting the humble retail investor'.[602] These are all recognitions of the limits of efficient markets disciplinary mechanisms, but importantly, the essential contribution of financial products 'to daily life as a consequence of government withdrawal from welfare'.[603]

It resulted in disclosure documents based on UCITS standards, being 'a highly regulated, supervised, and transparent savings vehicle'.[604] These standards are regulated by a series of EU directives from 2001.[605] Disclosure standards are supported by MiFID regulation of conduct standards in the relationship between investor, product issuer and financial adviser, based on best interest of the investor.[606] The [MiFID] conduct of business regime:

> Catches services from those with minimal intermediation – classically execution-only broking – to those involving a high degree of loss of control by investors and large degrees of investment firm discretion and investor risk, such as portfolio management.[607]

The scope of the MiFID regime includes general and specific financial advice, investment research, marketing and advertising materials with disclosure underpinning investor protection and investor choice of financial product. Disclosure must be in a 'comprehensible form'.[608] Disclosure 'standardisation and greater comparability'[609] reflect the intent of UCITS disclosure documents. UCITS was designed as a means of passporting financial products between jurisdictions including Singapore and Hong Kong (not Australia). Reform of passporting[610] in 2013 applies to the marketing

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601 Armour, Bengtzen and Enriques, above n 174, [7.1].
602 Moloney, 'The Investor Model Underlying the EU's Investor Protection Regime', above n 482, 171; See generally P Davis, 'Protecting Investors Proves Tricky' 21 *Financial Times Funds Management* 11.
603 Moloney, 'The Investor Model Underlying the EU's Investor Protection Regime', above n 482, 173.
604 Moloney, 'Building a Retail Investment Culture through Law', above n 467, 352.
605 *Directive 2001/107/EC of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses (UCITS)* [2001] OJ L 41/35.
606 *Directive 2004/39/EC of the European Parliament and of the Council on Markets in Financial Instruments (MiFID of April 21, 2004)* [2004] 39, art 19(1).
607 Moloney, 'Building a Retail Investment Culture through Law', above n 467, 380.
608 Ibid 386.
609 Ibid 395.
610 Eilis Ferran, 'After the Crisis: The Regulation of Hedge Funds and Private Equity in the EU' (2011) 12 *European Business Organisation Law Review* 379, 405.

of non-EU financial products inside the EU with different regulations applying to EU and non-EU fund managers and funds.[611] Thus, as in Australia, political pressures on regulators' 'pro-market, deregulatory preferences … give way to "stronger" and "stricter" regulation'.[612]

Disclosure includes breach of fiduciary obligation by the non-disclosure of conflicts of interest or of remuneration. In Germany, this may result in advisory contract rescission[613] and breach of statute.[614] Collective redress mechanisms as a result of judicial overload led to the development of model case procedures designed to:

> [i]mprove individual investor protection by facilitating the enforcement of individual claims, to facilitate the enforcement of capital markets regulation, and to reduce the burden on the judicial system,[615]

with redress (including damages) for misleading, inaccurate or incomplete capital markets disclosures. German and Austrian courts, unlike Australia:[616]

> interpret the concept of prospectus liability to as to include promotional statements and brochures, and thus acknowledges that general prospectus liability under civil law also extends to these materials, even though they may be separate from the actual prospectus,[617]

although no 'concrete rules exist as to the required contents and presentation of the advertising materials.'[618]

The German model case procedures differ from those elsewhere in the EU and retain significant individual rights with only a 'partial collectivisation of claims'[619] and includes opt-out procedures. German civil law provides additional avenues for investor protection should the MiFID regime fail

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[611] *Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010* [2011] 61/8.
[612] Ferran, above n 610, 412–13.
[613] Roman Inderst, 'Retail Finance: Thoughts on Reshaping Regulation and Consumer Protection after the Financial Crisis' (2009) 10 *European Business Organisation Law Review* 455, 456.
[614] *Securities Trading Act* (Germany) 1998 ('WHpG') § 31d.
[615] Brigitte Haar, 'Investor Protection Through Model Case Procedures — Implementing Collective Goals and Individual Rights Under the 2012 Amendment to the German Capital Markets Model Case Act ("KapMuG")' (2014) 15 *European Business Organisation Law Review* 83, 97.
[616] *Corporations Act 2001* (Cth) s 1041E. This section does not extend prospectus or regulated financial product offer document liability to general marketing materials which are not capable of acceptance. ASIC publishes a series of Regulatory Guides for non-offer document market conduct. See , eg ASIC RG 38 (hawking), ASIC RG 53 (dissemination of past performance data), RG 254 (advertising).
[617] Haar, above n 615, 220.
[618] Ibid 235.
[619] Ibid 101.

in its ex ante preventive objectives. Liability is personal requiring 'conscious awareness'[620] of persons making untrue representations or omitting material facts relevant to investment decisions. Consumer protection through disclosure applies to both financial markets law (disclosure to markets) and company law (disclosure to shareholders), resulting in more than one set of disclosure rules.[621] Corporate governance based on soft-law codes adds further complexity to disclosure with lack of harmonisation in enforcement. This lack of harmonisation extends to cross-border investment activity with Brexit adding to the complexity.[622]

Disclosure is a commonly applied regulatory tool globally, but it has its limitations, being 'neither effective nor efficient'.[623] A common complaint is the complexity of disclosure documents, reducing the ability of the stakeholder to understand and use the disclosed information. Is disclosure a lazy tool, or the easiest solution for policy makers? '[O]ne cannot entirely rule out the suspicion that legislators have chosen disclosure because they themselves do not fully understand the consequences of the mechanisms...'[624]

In the EU, there is now the 'eclipse of the empowered investor and the emergence of the consumer'.[625] Reforms which recognise the 'limits of disclosure, where relied on, is outcomes-based' ... 'on ex ante and ex post product intervention – not on further responsibilising [sic] the investor through disclosure'.[626] Unlike Australia, with the exception of consumer credit and industry superannuation default funds,

> the emergence of a precautionary, ex ante approach to retail markets is one of the most striking themes of the current generation of reforms, particularly with respect to product design-related intervention, but also as regards product distribution…[627]

[620] Guido Kordel, 'Behavioral Corporate Governance from a Regulatory Perspective: Potentials and Limits of Regulatory Intervention to Impact the Conduct of Corporate Actors' (2008) 9 *European Business Organisation Law Review* 29, 51.
[621] *Commission v Germany* (C–274/87) [1989] ECR 229; *Centros Ltd* (C–212/97) [1999] ECR I–1459; *Inspire Art* (C–167/01) [2003] ECR I–10155.
[622] Armour, Bengtzen and Enriques, above n 174, [7.1]–[7.4].
[623] Karsten Engsig Sorensen, 'Disclosure in EU Corporate Governance — A Remedy in Need of Adjustment?' (2009) 10 *European Business Organisation Law Review* 255, 271.
[624] Ibid 274.
[625] Moloney, 'The Investor Model Underlying the EU's Investor Protection Regime', above n 482, 179.
[626] Ibid 184.
[627] Ibid 178.

Australia is not unique in suffering from systemic creeping corruption arising from disclosure limitations. 'Schaeffler's scheme was carefully and skilfully crafted in order to avoid any formal violation of the law, straddling the thin line between legal and illegal'.[628]

> [O]nly a fraction of the facts comprising Schaeffler's strategy was disclosed to the public and/or regulators. Consequently, only a fraction of the facts can be assessed by the capital markets. What can we do about it? [629]

Can complete disclosure of economic interest be enforced where there is no legal obligation to do so? Where there is no interest in it by the parties concerned? 'It is necessary to shift legislator's attention from ex post enforcement to [an] ex ante self-regulatory regime'.[630]

6.3 United Kingdom

Market based regulatory systems rely heavily on disclosure, including disclosure of conflicts of interest. 'Such disclosure is worse than useless if it is not comprehensive'.[631]

> The belief that the best approach to information asymmetry is the provision of additional data … [is] acceptable if accompanied by full, even if largely incomprehensible, disclosure.[632]

It leads to documentation complexities which hide the narrative required to make sound investment decisions. 'The addition of successive layers of oversight and accountability through disclosure not only adds to cost but also dilutes trust and judgment…'[633] 'Two dimensions of disclosure have been particularly problematic,'[634] including investor protection and market integrity. For these investors, it may be 'information asymmetry problems exceed[s] the bounds that can realistically be remedied by disclosure.'[635] Market integrity and transparency is regulated through the disclosure of short positions,[636] with the power to regulate 'on financial stability grounds'.[637]

Best interest and general law fiduciary obligations of investment intermediaries rely on disclosure of conflicts of interest and the concept of informed consent. They ignore the concept of stewardship

[628] Zetzsche, above n 231, 141.
[629] Ibid 145.
[630] Ibid 146.
[631] Kay, above n 297, 67.
[632] Ibid 35.
[633] Ibid 46.
[634] MacNeil, above n 276, 512.
[635] Ibid.
[636] *Extension of the Short Selling Disclosure Obligation* (FSA Consultation Paper 09/15, June 2009) cited in MacNeil, above n 276, 516.
[637] *Financial Services Act 2010* (UK) s 8; See MacNeil, above n 276, 516.

espoused, unsuccessfully to date in its fiduciary sense, in the UK. Stewardship requires that information 'should as far as possible be tailored to the needs of users.'[638] Verbiage and boilerplate text which populate Australian offer documents and financial advice may provide data, but it is not useful information usable by the financial consumer. US offer documents management discussion sections provide more usable information.

> Data is not information, information is not knowledge, knowledge is not understanding, understanding is not wisdom.[639]

Disclosure has become an end in itself, reflecting regulation of market behaviour through process rather than the primacy of the investor or beneficiary reliant upon trusted financial intermediaries. A 'distinctive feature[s] of the UK's regulations … requiring an unusually rigorous insistence on accurate self-labelling'[640] are product based, not client based. Regulation is seen 'through the eyes of the industry rather than its customers'[641] with penalties for 'market abuse rather than customer abuse'.[642] Disclosure is at best an imperfect tool in a consumer market structure with considerable information asymmetries and permissible conflicts of interest. What financial consumers need is trust generated by long term 'deeper'[643] relationships. This is the European tradition, albeit subverted (as in the UK) since 2004 by the advent of product selling and transactional relationships. The banning of commissions paid to financial advisers is a first step[644] to rectifying loss of trust by radical changes to culture and behaviour. The Heydon Royal Commission identified Australian echoes: 'culture and taint'[645] requiring excision.

6.4 United States

Debate in the US, has centred on fiduciary characteristics of the client relationship and, in the alternate, standards of client disclosure preferred by the Securities Industry and Financial Markets Association (SIFMA). As in Australia since Wallis, disclosure has been the historical basis of US securities laws. 'Sunlight is said to be the best of disinfectants; electric light the most efficient

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[638] Kay, above n 297, 46.
[639] Ibid 71.
[640] Bateman and Kingston, above n 104, 10.
[641] Kay, above n 297, 47.
[642] Ibid.
[643] Ibid 46.
[644] *Retail Distribution Review: Independent and restricted advice* (Financial Services Authority UK, June 2012).
[645] Commonwealth of Australia, Royal Commission into Trade Union Corruption and Governance, above n 364, ch 4 [10] (Commissioner Heydon).

policeman'.[646] For retail investors with limited time and limited financial literacy, it is an imperfect tool despite its historical provenance.

[646] Demina, above n 121, 440 citing Louis D Brandeis, *Other Peoples' Money and How the Bankers Use It* (F A Stokes Co, 1914).

7. FINANCIAL LITERACY

7.1 Singapore

Reliance on disclosure in financial products and financial services requires financial literacy competencies from consumers. Financial literacy is taught under the well-regarded MoneySENSE national financial education program.[647] Launched in 2003, it provides games and workshops for secondary students possibly extended to primary school students. MoneySENSE research shows that sound money habits have crystallised as young as age seven. Tutors involved in financial education receive training so that they can deliver the program effectively.

7.2 Germany and the EU

Law reform was designed to unlock retail investor savings relying on their financial literacy (but without formal investor education) and on advice. This required financial products 'easily understood by the 'average retail investor…'[648]

Disclosure and best interest policy has not been sufficient to prevent 'serious signs of some form of market failure'.[649] This reflects the paternalist view that investors should not be trusted with their own money despite,

> new evidence suggesting that retail investors are less irrational than frequently assumed, the more traditional characterization of the erratic and undesirable investor, vividly described as the 'weak animal that must sadly but necessarily be culled out of the investing herd to improve the species'.[650]

Some individual investors do exhibit traits leading to losses, or may fail to distinguish between fiduciary and broker relationships.[651] This is not the same as market failure. Paternalist remedies may not therefore be relevant. 'Regulatory failure linked to the investor empowerment model is closely implicated'.[652] There is a link between paternalism and the lack of development of financial literacy to make informed decisions, although '"Learning by doing" may be hard or even impossible…'.[653] Australia echoes these distinctions with its policy conflicts on superannuation regulation. All

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[647] MAS, *Objectives and Principles of Financial Supervision in Singapore*, above n 4, 5.12.
[648] Moloney, 'Building a Retail Investment Culture through Law', above n 467, 352.
[649] Klöhn, above n 493, 445.
[650] Stout, above n 474, 35; Moloney, 'Building a Retail Investment Culture through Law', above n 467, 345.
[651] Roman Inderst and Marco Ottaviani, 'Regulating Financial Advice' (2012) 13 *European Business Organisation Law Review* 237, 245.
[652] Moloney, 'The Investor Model Underlying the EU's Investor Protection Regime', above n 482, 176.
[653] Inderst and Ottaviani, above n 651, 239.

jurisdictions should be cautious of confusing paternalism, however libertarian, with regulation designed for efficient capital markets, one component being financial literacy.

> Government interference in the subprime market created the seeds of destruction and, at least in some countries such as Germany, it were in particular banks with politicians on their boards, such as the Landesbanken [State Banks], who took the worst gambles.[654]

Scholarly research has 'exposed simmering tensions between the advocates of paternalism and the investor empowerment camp.'[655] If paternalism is not the answer to retail investor protection as consumers, are the tools available to those investors: disclosure, suitability/appropriateness assessed by advisers, and investor education, of themselves, sufficient? There is no clear answer in EU regulation or statute. There is a legal answer in the widespread application of the German *untreue* and *culpa in contrahendo* doctrines supported by 'micro-protection'[656] of investors under consumer protection regulations. These reforms recognise that:

> While financial literacy remains a recurring theme of policy debate recognition now seems to be growing that literacy is, at best, a very long term solution and can play only a supporting role in protecting investors.[657]

This conclusion applies also in Australia. However, there has not yet been evolution of the law (other than consumer credit and industry superannuation default funds) to reflect investors as consumers rather than capital providers. Neither is there an adequate separation of financial products issuers associated with discretionary investment from those that issue financial products essential for welfare. In Australia, these are often intermingled (eg MIS, superannuation entities, and financial advisers in the same corporate group) with some superannuation entities assuming investment bank risk.

7.3 United Kingdom

Fundamental to the discipline of any market based regulatory system operating in a general law framework is financial literacy and consumer comprehension of financial services and financial products. UK research into financial literacy is extensive.[658] The then Financial Services Authority

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[654] Inderst, above n 613, 462.
[655] Niamh Moloney, *How to protect Investors: Lessons from the EC and the UK* (Cambridge University Press, 2010) cited in Emilios Avgouleas, 'Book Review [*How to protect Investors: Lessons from the EC and the UK*] (2012) 13 *European Business Organisation Law Review* 497, 498.
[656] Eddy Wymeersch, 'Europe's new financial regulatory bodies' (2011) 11(2) *Journal of Corporate Law Studies* 443, 461.
[657] Moloney, 'The Investor Model Underlying the EU's Investor Protection Regime', above n 482, 184.
[658] *Building Financial Capability in the UK* (Financial Services Authority, Financial Capability Steering Group, 2004).

(precursor to FCA and PRA) recognised the need for 'collaboration among the public, private, and non-profit sectors,'[659] including the free Money Advice Service. Importantly:

> Improving financial capability [of consumers] is complimentary to, and not a substitute for, firms treating their customers fairly – and there are some firms which still have not embedded this principle into their management culture and which now need to do so.[660]

UK empirical research mirrors other jurisdictions: financial literacy is an imperfect tool for market discipline. '[R]igorous, credible policy evaluation showing the incremental impact of financial capability work is hard to find'.[661] Financial capability research of important population cohorts (school age children, young people not in education, tertiary students, employees, new parents) found 'insufficient robust evidence'[662] to make 'plausible estimates of the proportion of people likely to respond to types of financial capability initiatives by making changes in their behaviour, and the extent of any changes they make to their personal finances.'[663] Achieving widespread behavioural change (as ASIC has recognised in Australia) 'will be a long process'.[664]

> psychological rather than informational differences may explain much of the variation in financial capability … people's financial behaviour may primarily depend on their intrinsic psychological attributes rather than information or skills or how they choose to deploy them.[665]

Behavioural economics research suggests that the use of peer group norms and 'active intervention by a counsellor and/or individualised advice, rather than passive information or education'[666] are the most promising forms of incrementing financial literacy and its application. The Canadian SRO model provides the infrastructure to achieve such a result. The present Australian financial literacy strategies do not.

Given the long lead times to develop market disciplinary competencies by financial consumers, fiduciary principles must therefore bear the heavy burden of protection of the vulnerable through

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[659] Saul Schwartz, 'The Canadian Task Force on Financial Literacy: Consulting without listening' [2011] 51 *Canadian Business Law Journal* 338, 341.
[660] Ibid.
[661] Mary Anne Waldron, 'Unanswered questions about Canada's Financial Literacy Strategy: A comment on the report of the Federal Task Force' (2011) 51 *Canadian Business Law Review* 361, 365 citing Adele Atkinson, *Evidence of Impact: An overview of Financial Education Evaluations* (Financial Services Authority, 2009).
[662] Atkinson, above n 661, 68 [4].
[663] Ibid [13].
[664] Ibid.
[665] David de Meza, Bernd Irlenbusch and Diane Reyniers, *Financial Capability: A Behavioural Economics Perspective* (Financial Services Authority Consumer Research, 2008) 68.
[666] Ibid.

market conduct discipline and enforcement. This is especially so since financial services and financial products have become consumer purchases. Investors as consumers is recognised policy in Germany. Previously, most financial products and services were accessed by limited numbers of sophisticated investors. Nowadays, most of the population, much of which does not have financial literacy competencies, relies on third party products and services providers to plan and access retirement funds. This population is particularly vulnerable and requires fiduciary protections. Successful financial intermediation depends on trust and confidence: 'taken together, rather than separately, they imply a financial world different from our recent experience'.[667]

7.4 Canada

Canada does not only rely on Responsive Regulation. As in other jurisdictions, market mechanisms are sought to provide discipline to financial advisers through financial literacy. '[I]t is time to replace antiseptic education with castigation and terror'.[668] Canadian attempts to improve financial services consumer literacy have been highly politicised '[d]riven by the twin desires to avoid any increased regulation of the financial services industry and to avoid the debate that surrounds the efficacy of financial education'.[669] '[4]9.5% of adult Canadians struggle with simple tasks involving math and numbers and 42% of adult Canadians struggle with reading'.[670] The proposed Canadian model,[671] whilst meritorious in acknowledging the importance of behavioural economics rather than statutory compliance 'clearly privileges the expansion of financial education as the preferred method to improve financial literacy',[672] with design and delivery by governments. 'Despite [the] seeming abundance of programs (and a statutory obligation on the part of many governments to provide such education), no strong consensus exists about the general effectiveness of the financial education programs'.[673]

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[667] Kay, above n 297, 5.
[668] John A E Pottow, 'Financial Literacy or Financial Castigation' [2011] 51 *Canadian Business Law Journal* 394, 406.
[669] Schwartz, above n 659, 339.
[670] Waldron, above n 661, 368.
[671] *Canadians and their Money: Building a Brighter Financial Future* (Task Force on Financial Literacy, Ottawa, 2010).
[672] Schwartz, above n 659, 344.
[673] Ibid 345 citing Joanne Yoong, *Retirement Preparedness and Individual Decision Making: Implications for Canada* (Research Report, Task Force on Financial Literacy, Ottawa, 2011).

> Financial education does not automatically lead to financial literacy and the ability to make rational informed decisions about complex financial products, especially when government is 'the major driving force'.[674]

There is a 'dizzying array'[675] of government agencies involved in financial literacy education. Canada's emphasis on self-regulation and financial literacy education developed avoidance of conflicts of interest by advisers who have no business judgment rule to rely on. Previously, 'Calls for holding such advisers to a fiduciary standard were simply ignored...'[676] The delivery of education and disclosure of information, even with responsibility to ensure 'that it is fully understood by Canadians at "teachable moments"'[677] is not the same as financial literacy. It is still a lesser obligation than the German *culpa in contrahendo* standard. This latter standard would motivate cultural change in financial products and services providers rather than reliance on '[d]isclosure (assisted by financial literacy education) as the primary consumer protection model…'[678] Calls from the libertarian paternalists for restrictions on the availability of financial products (often from Canadian trades unions) can be resisted with decision making responsibility remaining with the individual.

7.5 United States

'Positive outcomes for some US financial literacy programs have been attributed more to the advice provided than to simple education'.[679]

> Many of the seemingly successful financial education courses studied to date may actually owe their success not due to the direct content of the information conveyed but due to their collateral consequences, such as individual counsel[l]ing with an instructor…,[680]

being 'teachable moments'.

Disclosure alone determines issuer document content and for whom financial products can be marketed. Fiduciary standards determine how and to whom financial products can be sold. Disclosure assumes financial literacy and the investor's ability to make a rational informed choice and change

[674] Schwartz, above n 659, 351.
[675] Pottow, above n 668. This array includes the Financial Education Institute of Canada, Financial Consumer Agency of Canada, Financial Planning Standards Council, Investor Education Fund and the National Advisory Council.
[676] Schwartz, above n 659, 359.
[677] Ibid 352. This aphorism may have been first coined by Bill Cheeks in the US. Interview with Diane Tate, Australian Bankers Association (Sydney, 2017).
[678] Waldron, above n 661, 374.
[679] Ibid 376.
[680] Pottow, above n 668, 402.

their behaviours. Financial education can have a 'positive but modest impact'.[681] As in Canadian financial literacy scholarship:

> the availability of data does not always lead to effective communication and knowledge; understanding and intention do not necessarily lead to a desired action; and … contextual nuances can shape behaviour and alter choices.[682]

The US has a Federal Financial Literacy and Education Commission. Controversially deemed insufficient,[683] mandatory financial education for debtors[684] is presently enforced by the Consumer Financial Protection Bureau (CFPB) a quasi-autonomous agency within the Federal Reserve System. Reform proposals,[685] yet to be enacted, move the CFPB out of the Federal Reserve into an independent congressionally funded consumer protection agency. The CFPB has:

> unprecedented authority over financial institutions and main street businesses. The CFPB director will have vast rule-making, supervisory, investigative and enforcement powers and the authority to regulate any person or business that offers or sells a 'financial product or service'. This authority will extend to not just traditional financial institutions, but also potentially thousands of entrepreneurs and small businesses.[686]

In the US, financial literacy education has become an easier pathway than financial services reform. 'Education is a winning strategy'[687] politically, but lacks empirical support.[688] Nonetheless forcible conscription arising from:

> the attitude of denial that has taken hold in the US – the near unshakeable belief that financial literacy and education is the low-cost panacea to consumer financial distress,[689]

partly explains the superiority of financial services regulation in Canada.

The US model is more akin to Australian regulation. Compliance rather than self-regulation, with financial literacy education as the sop to more insightful solutions to systemic problems. It is no

[681] Demina, above n 121, 457 citing de Meza, Irlenbusch and Reyniers, above n 665, 69 [20].
[682] Ibid 452 citing Michael S Barr et al, 'The Case for Behaviourally Informed Regulation' in David Moss and John Cisterino (eds), *New Perspectives on Regulation* (The Tobin Project, 2009) ch 2, 25–26.
[683] CCH Attorney-Editor and Staff, above n 165.
[684] *Bankruptcy Abuse Prevention and Consumer Protection Act 2005* (US) Public Law No 109–8.
[685] *Financial Choice Act of 2017* (US) 10 HR.
[686] Pottow, above n 668, 395.
[687] Waldron, above n 661, 364 citing L E Willis 'Against Financial-Literacy Education' (2008) 94 *Iowa Law Review* 264.
[688] Ibid.
[689] Pottow, above n 668, 401.

coincidence that the outcomes – cyclical manifestations of systemic failures – arise in both jurisdictions. Similarly the reluctance to embrace holistic fiduciary standards and obligations sets the US, Australia and the UK apart from the Canadian and German models.

8. CORPORATE GOVERNANCE

8.1 Germany and the EU

8.1.1 Corporate Governance in German NBFEs

There is considerable disharmony in Australia surrounding the governance of some NBFEs. Important trustee reform attempts[690] in governance of superannuation entities remains contested and unresolved. These entities form significant proportions of the Australian capital market, some operate globally, and some assume investment bank risk. Conflict and confusion arises from the different roles of representative stakeholders and board level competencies required to supervise management. Rational reform has been delayed by the politicisation of these sectors.

Balancing stakeholder interests with supervision of management competencies has long been a feature of the German corporate governance environment for listed public companies (and other entities). Because of the size, complexity, and economic importance of NBFEs, 'it can be expected that the rules applicable to listed companies will sooner or later become a measurement for standards of conduct to be re-imposed on unlisted companies by case law or by rulings of financial authorities.'[691] This has already occurred in Belgium, Finland and Switzerland.[692]

The two tier board structure, originally to diffuse power for shareholder and public interest protections, separates stakeholder supervision from management control. The board has two elements: Supervisory Board (*Aufsichtsrat*) and Management Board (*Vorstand*).

> It is a substantial insight of the European Commission to make sure, that the management function will be submitted to an effective and sufficiently independent oversight function … this requires the presence on the supervisory board of a sufficient number of committed non-executive or supervisory directors, who, in addition to not performing management duties in the company or its group, are independent, i.e. free from any material conflict of interest.[693]

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[690] Fair Work (Registered Organisations) Bill 2013 (Cth), Fair Work (Registered Organisations) Amendment Bill 2014 (Cth), Fair Work (Registered Organisations) Amendment Bill 2014 [No 2] (Cth); Superannuation Legislation Amendment (Trustee Governance) Bill 2015 (Cth); *Fair Work (Registered Organisations) Amendment Act 2016* (Cth).

[691] Hopt and Leyens, above n 54, 162.

[692] Joseph A McCahery and Erik P M Vermeulen, *Corporate Governance of Non-listed Companies* (Oxford University Press, 2008) cited in Vuk Radovic, 'Book Review [*Corporate Governance of Non-listed Companies*]' (2011/2012) 12 *European Businesss Organisation Law Review* 353, 355.

[693] Ingo Saenger, 'Conflicts of Interest of Supervisory Board Members in a German Stock Corporation and the Demand for their Independence' (2005) 1 *Corporate Governance Law Review* 147, 148.

This insight has not applied in Australia since 1998 when prescribed interests (predating the *Managed Investments Act*)[694] separated trustee and investment management.

The supervisory board appoints, removes, and supervises (but does not control) the management board ensuring it has the needed skills sets to perform its duties, and is the guardian of the shareholder and employee interests.[695] The 'advantage of the German system is the clear division of function'.[696] The management board 'is in charge of the company according to its own business judgment and represents the company in its business dealings and in litigation'.[697] The supervisory board approves defined types of transactions. Approval rights include the contract for the engagement of the auditor. These 'approval rights play an important role and are sometimes used to substantially extend the powers of the supervisory board'.[698] The supervisory board 'is increasingly performing active advisory, support, and co-decision making functions'.[699] In the event of a proposed sale of an entity by the supervisory board, it is the management board that has the responsibility to provide due diligence information to a potential purchaser. The management board has that legal power, but it must 'balance the interests between the disclosure and protection of information for the interest of the company'.[700] This is the two-tier model at work, separating the interests of the shareholders (represented by the supervisory board) from the interests of the company where the disclosure of confidential information could harm the company and ultimately its shareholders.

The supervisory board is historically 'responsible for bringing actions of the company against members of the management board'[701] Shareholders also have the right of derivative action 'against acts of the management board which, through valid and binding relationships with third parties, infringe upon the rights of the shareholders' meeting,[702] thus extending 'shareholder rights to vote on fundamental corporate transactions'[703] Since 2004, shareholders have been able to bring an action

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[694] *Managed Investments Act 1998* (Cth), now ch 5C of the *Corporations Act 2001* (Cth).
[695] Hopt and Leyens, above n 54, 141.
[696] Grit Tüngler, 'The Anglo-American Board of Directors and the German Supervisory Board — Marionettes in a Puppet Theatre of Corporate Governance or Efficient Controlling Devices' (2000) 12(2) *Bond Law Review* 230, 269.
[697] Ibid 232.
[698] Hopt and Leyens, above n 54, 141.
[699] Gerhard Cromme, 'Corporate Governance in Germany and the German Corporate Governance Code' (2005) 13(3) *Corporate Governance: The international journal of business in society* 362, 365.
[700] Maximilian Rittmeister, 'The Management Board's permission to disclose Due Diligence Information before a Corporate Acquisition in consideration of the Impact of the Act to Improve the Protection of Investors (Gesestz zur Verbesserug des Anlegerschutzes)' (2005) 6 *German Law Journal* 549, 561.
[701] Hopt and Leyens, above n 54, 142.
[702] Schnorbus, above n 264, 605; *Holzmüller,* Bundesgerichtshof [Federal Court of Justice] 11 ZR 174/80 (February 25 1982) 83, 122.
[703] Schnorbus, above n 264, 605.

against both boards.[704] These actions are constrained by business judgment doctrine and the different legal foundation of fiduciary duty in Germany. The cases reserve 'the most important key decisions'[705] to the shareholders. Supervisory board statutory responsibilities[706] have been judicially interpreted:

> This control does not only relate to completed issues, but also points of principles of the future business policy; is not limited to a review of legality, but must include the management's expediency and thrift. Monitoring functions understood in this regard can only be effectively exercised by regular discussions with the management board and its ongoing consultancy; therefore, counselling is the leading instrument of a future-oriented management supervision.[707]

German statutory provisions are extensively supported by soft law designed to promote 'a culture of open discussion in managerial and supervisory bodies'.[708] This includes the extra-judicial GCGC,[709] the OECD Ad-Hoc Task Force on Corporate Governance, and institutional activism.[710] The corporate governance code 'strengthened the strategic role of the supervisory board',[711] now given statutory force,[712] and updated annually. Since 2012, companies have to explain their reasons for noncompliance.[713]

The GCGC as general law provides guidance on limiting potential conflicts of interest of supervisory board membership in the exercise of its power to limit management board deviations from best interest of the enterprise and to ensure that:

> supervisory board members in addition to not performing management duties in the company, not to have any other significant relationship (significant shareholder, employee, other) with the company.[714]

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[704] Cromme, above n 699, 365.
[705] Carsten Jungmann, 'The effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems' (2006) 3 *European Company and Financial Law Review* 426, 435.
[706] *Stock Corporation Act* (Germany) 1965 ('AktG') § 111.
[707] *Foster v British Gas*, Bundesgerichtshofzivil [Federal Court of Justice Civil] (3 March 1991) 11 ZR 188/89.
[708] Tüngler, above n 696, 245.
[709] German Corporate Governance Code.
[710] Tüngler, above n 696, 268.
[711] Hopt and Leyens, above n 54.
[712] *Stock Corporation Act* (Germany) 1965 ('AktG') § 161.
[713] Thomas Kaspereit, Kerstin Lopatta, and Dennis Onnen, 'Shareholder Value Implications of Compliance with the German Corporate Governance Code' (2015) in *Managerial and Decision Economics,* wileyonlinelibrary.com DOI:10.1002/mde.2750.
[714] Saenger, above n 693, 175.

These evolving policies had ‘significant majority’[715] support. Compare Australian NBFEs plagued with abhorrent and egregious related parties and conflicts of economic interest.

There is an ‘ongoing discussion on the legal nature of the Code … particularly in Germany,’[716] being a balance of soft law and statute. There is no pan-EU standard: ‘a mix of different types of regulation on corporate governance exists, and the dividing line between self-regulation and state regulation is a sliding one’.[717] The increasing trend to soft law provides companies with flexibility and is reflected in German company law. Entrepreneurial companies benefit from this flexibility including compliance and executive time costs reductions.[718] With flexibility comes responsibility. Directors of listed and unlisted companies may be liable for not meeting comply-or-explain provisions of the GCGC or merely for not acting in accordance with a specific governance rule.[719] Modern German legal practice places responsibility for management supervision with the individual directors of the supervisory board and provides them with ‘sufficient power to focus the managers’ minds in the right direction’.[720] ‘Promoting entrepreneurship is high on the agenda … and reflected in a number of company law [reform] initiatives’.[721] Whilst partly a response to corporate mobility, treaty shopping or ‘regulatory arbitrage’ around the EU, it is also a recognition that ‘regulatory burdens generally have a negative effect on entrepreneurship.’[722]

8.1.2 Fit and proper: profession of director in Germany

Supervisory Board appointments are often recommended by management and approved by shareholders. ‘[T]he definition of “adequacy” by the management board does not necessarily correspond with the shareholders’ definition of “adequacy”’.[723] Previous criticism of adequacy removed historical co-determination provisions and to excessive risk taking exposed by the GFC. ‘directors sometimes showed serious deficits in understanding the business they were supposed to control, and remained passive in addressing structural problems’.[724] The German model for listed

[715] Ibid 185.
[716] Michael Kort, ‘Standardization of Company Law in Germany, other EU Member States and Turkey by Corporate Governance Rules’ (2008) 5 *European Company and Financial Law Review*, 379, 414.
[717] Ibid 416 citing E Wymeersch, *Enforcement of Corporate Governance Codes* (Law Working Paper, European Corporate Governance Institute No 46/2005) 3.
[718] Ibid 418.
[719] Ibid 417–418.
[720] Andrew Ross and Kenny Crossan, ‘A review of the influence of corporate governance on the banking crises in the UK and Germany’ (2012) 12(2) *Corporate Governance: The international journal of business in society* 215, 223.
[721] Mette Neville and Karsten Engsig Sorensen, ‘Promoting Entrepreneurship — The New Company Law Agenda’ (2014) 15 *European Business Organisation Law Review* 545.
[722] Ibid 454.
[723] Jungmann, above n 705, 450.
[724] Ringe, above n 251.

public company governance previously applied the principal of 'codetermination' (now removed) with representatives of employees (directly or trades union representation) and capital (traditionally shareholders and banks).[725] Co-determination did not apply to unlisted entities. These include unlisted public companies (AG), private companies (Gmbh) and limited partnerships (KG). A supervisory board is voluntary for a Gmbh and unlisted AG (a KG does not have a supervisory board).

Qualifications for supervisory board membership include diversity of knowledge, judgment, and experience.[726] German and EU law requires directors of German entities to have 'required knowledge, abilities, and expert experience to properly complete their tasks [although the German statutory requirement is for the] supervisory board as a whole to have this level of knowledge'.[727] Unlike Australia, which has virtually no mandatory qualification standards for directors (albeit enhanced for trustees), 'being the chairman of a supervisory board would become a profession in its own right',[728] with other board members being professionalised. Supervisory board members rely on information provided by the management board. Information flow has been enhanced with 'mandatory participation of auditors in the supervisory board's deliberations on the annual financial statements and reports, as well as the essential results of its audit …'[729] Board members are able to 'request additional information from the management board that goes beyond [its] regular reporting duties.'[730] The responsibility for having the required information rests with the supervisory board member. Similarly, responsibility for convening board meetings rests with each individual member so that they are able 'to do something on their own in order to detect and prevent corporate malfeasance'.[731]

8.1.3 Best interest duty in Germany

Directors have statutory and general law best interest duty (*Unternehmeninteresse*), described as 'contentious, contested, indefinable, vague, dazzling but dubious'.[732] The best interest duty is binding on each board. It is defined as 'the obligation to take care of the enterprises' [*Unternehmen*] continued existence and to ensure its durable profitability in a long term perspective':

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[725] Saenger, above n 693, 166.
[726] Ibid 186.
[727] Jungmann, above n 705, 457.
[728] Ibid 465.
[729] Jan Lieder, 'The German Supervisory Board on Its Way to Professionalism' (2010), 11 *German Law Journal* 115, 124.
[730] Ibid 126.
[731] Ibid.
[732] Saenger, above n 693, 154.

> Best interests of the enterprise includes all stakeholders including minorities, creditors, employees, public interest and is not limited to shareholder interests. …[733] It is designed to 'preclude the dominance of any specific group interests' and reduce the overall level of conflict by ensuring the common interest prevails.[734]

This broad best interest contrasts with Australia's several separate interpretations.

8.1.4 Empirical results of German corporate governance

The efficacy of governance determines long term empirical performance. This is nuanced as efficiency in Germany. Empirical research on the German two-tier board system dates from 1998.[735] Performance disclosure is publicly contested in Australia including in public advertising by superannuation industry associations, requiring regulatory intervention. 'Since 2002, [German] company law requires both boards of listed German corporations to declare their conformity to the German Corporate Governance Code'.[736] Empirical analysis demonstrates that:

> The degree of compliance with the Code is consistently value-relevant information for the capital market … Firms with a higher compliance are priced at an average premium … consistent with the hypothesis that there are capital market pressures (or at least incentives), suggesting a broad adoption of the Code...[737]

The average share price premium of €3.23 on a median of €29.17 and mean of €35.05 is significant. Unitary board models have not shown similar results.[738] If replicated in Australia, it implies foregone value to Australian NBFE securities holders and beneficiaries as a result of less optimal corporate governance practices. Later research (sample size 292 UK and German insurers and reinsurers) confirms these findings. There is,

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[733] Ibid 155.
[734] Andreas Hackethal, Reinhard H Schmidt and Marcel Tyrell, 'Banks and German Corporate Governance: on the way to a capital market-based system? (2005) 13(3) *Corporate Governance: The international journal of business in society* 397, 399.
[735] John H Farrar, 'In pursuit of an appropriate theoretical perspective and methodology for comparative corporate governance' (2001) 13 *Australian Journal of Corporate Law* 1.
[736] Igor Goncharov, Joerg Richard Werner and Jochen Zimmerman, 'Does Compliance with the German Corporate Governance Code have an Impact on Stock Valuation? An empirical analysis' (2006) 14(5) *Corporate Governance: The international journal of business in society* 432.
[737] Ibid 442.
[738] Kaspereit, Lopatta and Onnen, above n 713, 2015 citing D Laing and C M Weir, 'Governance structures, size and corporate performance in UK firms' (1999) 37 *Management Decision* 446, 457.

> a positive and significant estimate for the effect of corporate governance factor on opportunity asset risk, product risk, and financial risk … a positive relationship exists between corporate governance and risk taking in all three risk categories'[compensation, monitoring, blockholders].[739]

Corporate governance significantly affects risk taking in insurance companies with corporate governance and compensation being the primary factors in German entities. '[C]ompanies with increased monitoring (i.e. more independent board members and more board meetings) exhibit lower risk. For these companies, stricter monitoring of executives thus limits the opportunities for excessive risk taking'.[740]

> a higher level of compliance significantly increases shareholder value ... [we] conclude that the GCGC rules are meaningful to the market and that executives ought to pursue full compliance with the recommendations of the Code.[741]

This analysis of 2 379 German companies is robust, GCGC compliance associated with their higher market valuation.[742]

8.1.5 Market discipline: minority shareholder rights in German NBFEs

Statutory vagueness and the encouragement of entrepreneurship is balanced by minority shareholder statutory protections. These include remedies for groups of shareholders,[743] shareholder equality,[744] validity of shareholder resolutions,[745] and compulsory purchase of minority shareholdings by the company with court approved pricing.[746] Any shareholder owning more than one share or more than 1% of the issued capital can challenge the management and supervisory boards by derivative action. In German courts, 'refusal to grant permission is the exception if the other requirements of the law are satisfied'.[747] '[M]inority shareholder suits have been greatly facilitated'.[748] There is a considerable

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739 Martin Eling and Sebastian D Merek, 'Corporate Governance and Risk Taking: Evidence from the U.K. and German Insurance Markets' (2013) 81(3) *The Journal of Risk and Insurance* 653, 670.
740 Ibid 676–7.
741 Kaspereit, Lopatta and Onnen, above n 713.
742 Ibid.
743 *Stock Corporation Act* (Germany) 1965 ('AktG') §§ 15–18, [291]–[317].
744 Ibid § 53a.
745 Ibid §§ [241]–[249].
746 Braendle, above n 51, 261.
747 *Stock Corporation Act* (Germany) 1965 ('AktG') § 148 (1); Gerner-Beuerle and Schuster, above n 247, 217.
748 *Gesetz zur Unternehensintegrtät und Modernisierung des Anfechtungsrechts* [Law Furthering Corporate Integrity and Modernisation of the Regime Covering Shareholder Actions] (Germany) 2005 [2802] ('UMAG'); Gerner-Beuerle and Schuster, above n 247, 218.

body of litigation by derivative or direct suit instigated by minority shareholders in German companies.[749]

8.2 United Kingdom: The Profession of Director

UK company directors (and Australian directors deciphering differing interpretations of best interest) especially for those in the investment chain, need comprehension of the UK general law (and EU Directives). This is particularly so for those that engage in related party transactions. Comprehending the *Companies Act* alone does not suffice, although it does reinforce the proscriptive fiduciary tradition.[750] The UK relies heavily on private enforcement mechanisms for breaches of duty including derivative actions.[751] This reliance is regarded as 'ineffective'[752] and is being reviewed, as it was in Australia,[753] as result of community discontent with standards of corporate behaviour. The Australian model of public enforcement (since 1958)[754] is proposed but 'unlikely to be adopted in the UK.'[755]

Corporate governance failures have been cited as a cause of systemic failure in its financial system.

> The fact that different banks operating in the same geography, in the same financial and market environment and under the same regulatory arrangements generated such massively different outcomes can only be fully explained in terms of differences in the way they were run. Within the regulatory framework that is set, how banks are run is a matter for their boards, that is, of corporate governance.[756]

The Walker Review 'identified weaknesses in particular in … the expertise of non-executive directors … and inadequate capability of major investing institutions to protect the interests of those for whom they act'.[757] There was 'widespread failure on the part of boards of directors, and in particular independent non-executive directors, to understand and control the risks that were undertaken by their companies.'[758] These weaknesses are not restricted to banks. In the UK, as in Australia, the shadow

[749] *Corporate Litigation*, (Deutsche Anwaltsinstitut e.V. Fachinsitut für Handels- und Gesellschaftrecht, April 2005).
[750] Hannigan, 'Reconfiguring the No Conflict Rule', above n 371, 723.
[751] *Companies Act 2006* (UK) pt 11; Andrew Keay and Michelle Welsh, 'Enforcing breaches of director's duties by a public body and antipodean experiences' (2015) 15(2) *Journal of Corporate Law Studies* 256.
[752] Keay and Welsh, above n 751, 257.
[753] Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Company Directors Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* (1989) cited in Keay and Welsh, above n 751, 267.
[754] Keay and Welsh, above n 751, 266.
[755] Ibid.
[756] Sir David Walker, *A Review of Corporate Governance in the UK Banks and Other Financial Industry Entities* (July 2009) ['Walker Review'] cited in MacNeil, above n 276, 518.
[757] MacNeil, above n 276, 519.
[758] Ibid 518.

banks - NBFEs-play a major role in the financial system, but were not subject to the same prudential capital and liquidity regulation. This is now being imposed from the EU (particularly hedge funds and credit rating agencies)[759] the UK having a 'clear interest in ensuring that those markets remain centred in London.'[760] '[I]t cannot readily support forms of regulation that threaten its competitive position'.[761]

The Senior Management Regime (SMR) extends required competencies to executive and non-executive directors, senior management and their delegations. It includes those who have personal or corporate responsibility for failures in regulated firms. The SMR extends control of the 'entry into the relevant function and its performance',[762] to unregulated counterparties of regulated entities and to their service providers.[763] Its Australian equivalent (BEAR) presently only applies to ADIs. Singapore has a similar regime, although it is more extensive. Regulated entities to which SMR applies are required to 'set out for us simply and clearly-and not using a dictionary of legalese-what their responsibilities are[764] … the intent being to clearly identify 'who is in charge.'[765] Responsibility includes organisational culture and governance. [I]t is extremely hard, if not impossible, to either prescribe or supervise [organisational culture]'.[766] Governance extends to mandatory templates for employment references (to prevent recycling of individuals with poor conduct records) and deferral of performance based remuneration for up to ten years (as in the EU).[767] The SMR regime will extend to all UK financial institutions, foreign institutions operating in the UK from 2018, and Australian ADIs in 2018.

How do UK directors and trustees understand and manage their obligations where enforcement of incomplete and widening statutory codification requires reliance on general law, fiduciary principles are judicially interpreted traditionally rather than follow economic policy, and where there is increasing adoption of soft regulation, involuntary in practice?

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[759] *Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010* [2011] 61/8.
[760] MacNeil, above n 276, 513.
[761] Ibid 504.
[762] Ibid 508.
[763] Ibid 508–9; See generally 'Effective Corporate Governance (Significant Influence Controlled Functions and the Walker Review' (FCA Handbook, January 2010).
[764] James Proud, 'Financial Institutions supervision and culture' (Panel Discussion at the Federal Reserve Bank of New York Conference on Reforming Culture and Behaviour in the Financial Services Industry, New York, 20 October 2016) 3.
[765] Ibid.
[766] Ibid 2.
[767] Ibid 3–4.

9. NBFE ARCHITECTURES

9.1 NBFEs in Singapore

9.1.1 The evolution of trust law

Singapore trust law remains the English law of 1973 overlaid by Singapore trust law-related legislation since then.[768] Many Singapore NBFEs are large publicly traded commercial trusts, as in Australia and Canada. Presently, 'Singapore trust law provides an adequate legal framework for wealth management in Singapore and for protecting the interests of the parties to any Singapore or foreign trusts'.[769] '[T]oday's trust … has evolved into a management device for holding a portfolio of complex financial assets[770]… [which] requires skilled and active management on the part of trustees'.[771]

Risks for trustees are ameliorated by statute elsewhere[772] to prevent trustee flight, but not in Singapore or Australia. In Singapore, it is uncertain if UK general law applies.[773] There is no authoritative Australian leadership,[774] merely an agreement *in obiter* that: 'the irreducible core of obligations owed to beneficiaries only included the duty to "perform the trusts honestly" and to perform "in good faith" for the benefit of the beneficiaries'.[775]

Uncertainty also applies to constructive trusts.[776] Constructive trusts frequently are used as relief for a plethora of alleged breaches of trust, fraudulent or unconscionable conduct, breaches of fiduciary duty,[777] and breaches of confidence, leading to unjust enrichment. Yet, 'there is a tendency to conflate the constructive trust in a proprietary sense with a duty to account as constructive trustee'.[778]

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768 *Business Trusts Act* (Singapore, Act 30 of 2004); *The Trustees (Amendment) Act 2004* (Singapore) Act 45 of 2004.
769 Chan Sek Keong, 'Trusts and the rule of law in Singapore' (2013) *25 Singapore Academy of Law Journal* 365, 374.
770 A S Butler, 'Modern Portfolio Theory and Investment Powers of Trustees: The New Zealand Experience' (1995) 7(1) *Bond Law Review* 119.
771 Emma Ford, 'Trustee investment and modern portfolio theory' (1996) 10(4) *Trust Law International* 102.
772 *Trustees Act 2000* (UK) ch 29; *Uniform Trust Code 2000* (US) amend 2005.
773 *Armitage v Nurse* [1998] Ch 241 (CA); Chia Huai Yuan, 'Trustee exemption clauses & the modern day investment trust' (2013) 31 *Singapore Law Review* 199-202.
774 *Reader v Fried* [2001] VSC 495 (Pagone J).
775 Ibid [13] (Pagone J).
776 Tang Hang Wu, 'The Constructive Trust in Singapore — Five Persistent Puzzles' (2010) 22 *Singapore Academy of Law Journal* 136.
777 *Attorney-General for Hong Kong v Reid* [1994] 1 AC 324.
778 Wu, above n 776, 137.

Remedial constructive trusts are recognised in some jurisdictions[779] including the US and Canada, but not in others including the UK,[780] being 'a matter of strict law[,] not discretion'.[781]

> The Singapore approach, on the other hand, seems to be more ambivalent with regard to the possibility of a remedial constructive trust,[782] although there can be constructive trust liability arising from knowing receipt of property held by a fiduciary.[783]

This ambivalence stems from the distinction between accessorial liability[784] and dishonest assistance.[785] *Barnes v Addy* distinction being: 'a mere dicta in which he appeared not to strain the doctrine of trusts beyond its proper limits. This is increasingly being recognised both academically[786] and judicially'.[787]

The Singapore courts 'readily accept English and Privy Council cases as stating the applicable law with respect to the equitable liability of third parties to breach of trust and breach of fiduciary duty'.[788] They also look to Australian cases.[789] There is the beginnings of a distinct Singapore equitable jurisprudence: 'The Baden scale[790] has fallen into disfavour in Singapore'.[791] Establishing a Singapore specific legal system with independence from English or other jurisdictions with an equitable heritage reflects modern Singaporean society[792] balancing deterrence with efficient worldwide commerce.[793]

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779 *Muschinski v Dodds* (1985) 160 CLR 614 (Deane J).
780 *Re Polly Peck International plc (No 2)* [1998] 3 All ER 831.
781 Lord Neuberger, writing extra-curially, 'The Remedial Constructive Trust — Fact or Fiction' (Paper presented at Banking Services and Finance Law Association Conference, Queenstown, New Zealand, 10 August 2014).
782 Tsun Hang Tey, 'Constructive Trusts – Deciphering and Distinguishing 'Institutional' and 'Remedial' (2011) 23 *Singapore Academy of Law Journal* 250, 268 [54] citing *Chin Mun Fong v Lim Cho Chit* [2001] 1 SLR (R) 856 (L P Thean JA).
783 *Comboni Vincenzo v Shankar's Emporium (Pte Ltd)* [2007] 2 SLR (R) 1020 [52] (Kan Ting Chiu J).
784 *Royal Brunei Airlines Sdn Bhd v Philip Tan Kok Ming* [1995] 2 AC 378.
785 *Barnes v Addy* (1874) 9 Ch App 251.
786 Emmanuel Duncan Chua, 'Knowing, Dishonest or plain unjust? – a commentary on the past, present, and future of knowing receipt' (2007) 25 *Singapore Law Review* 53.
787 *Royal Brunei Airlines Sdn Bhd v Philip Tan Kok Ming* [1995] 2 AC 378.
788 *Attorney-General for Hong Kong v Reid* [1994] 1 AC 324; cited in Pauline Ridge, 'Equitable accessorial and recipient liability in Singapore' (2013) *Singapore Journal of Legal Studies* 361.
789 *Hospital Products Ltd v US Surgical Cor*poration [1984] HCA 64.
790 *Baden Delvaux v Societe Generale pour Favouriser le Development du Commerce et de l'Industrie en France SA* [1992] 4 All ER 161 [1993] 1 WLR 509, 575–6 [250].
791 Ridge, above n 788, 364.
792 Rachel Leow and Timothy Liau, 'Unjust enrichment and restitution in Singapore: Where now and where next?' [2013] *Singapore Journal of Legal Studies* 331.
793 See, eg, *Chan Yuen Lan v See Fong Mun* [2014] 3 SLR 1048; *Guy Neale v Nine Squares Pty Ltd* [2015] 1 SLR 1097; *Clearlab SG Pte Ltd v Ting Chong Chai* [2015] 1 SLR 163; *Wee Chiaw Sek Anna v Ng Li-Ann Genevieve* 3 SLR 801 [144] (Phang JA).

The law of equitable compensation for breach of fiduciary duty: 'has been in an unsettled state for some years'.[794] Singapore follows a strict interpretation of the *Brickenden*[795] rule:

> A fiduciary who is in one of the well-established categories of fiduciaries and who commits a culpable breach of his core duties of honesty and fidelity is liable to pay equitable compensation even if the object of those duties is unable to prove a but-for causation.[796]

This is different from the interpretation in Australia,[797] (or England) where proof of causation is required.[798] In Singapore, whether breaches of duty by a fiduciary are innocent or culpable[799] can render the fiduciary at risk without reliance upon a defence of causation.

Singapore relies on other (British) Commonwealth jurisdictions in its interpretation of trust law. It may follow English law by default, but there are trust circumstances relating to disclosure of information where: 'the issue has neither been decided nor explored',[800] in Singapore. There is uncertainty in the law. Application of Australian law is problematic where 'there remains no HCA decision relating to the beneficiaries' rights to trust information and documents'.[801] In Singapore, 'there are no hard and fast rules as to what information a trustee can, or cannot, be compelled to disclose'.[802]

9.1.2 Commercial trusts

Singapore law recognises and enforces trusts established under the law of any lawful jurisdiction. It also provides trust law recognition of S-REITs organised as CIS. Business Trusts may invest actively in real property. Statutory control over CIS securities offers, licensing, and authorisation,[803] and CIS trustees[804] demonstrates the differences between investment manager and trustee. This is different to

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794 Tan Ruo Yu, 'Causation in equitable compensation — The Brickenden Rule in Singapore' [2014] 26 *Singapore Academy of Law Journal* 724, 737.
795 *Brickenden v London Loan and Savings Company of Canada* [1934] 3 DLR 475.
796 *Then Khek Koon v Arjun Permanand Samtani* [2014] 1 SLR 245 (Coomaraswamy J); citing *Maryani Sadeli v Arjun Permanand Samtami* [2015] 1 SLR 496; Yu, above n 794, 725.
797 Matthew Conaglen, 'Remedial Ramifications of Conflicts between a Fiduciary's Duties' (2010) 126 *Law Quarterly Review* 72 [82].
798 *Watson v Ebsworth & Ebsworth* [2010] VSCA 335.
799 Yu, above n 794, 734.
800 Tsun Hang Tey, 'Trustee's duty of disclosure' (2012) 24 *Singapore Academy of Law Journal* 191, 216.
801 Ibid 210; J C Campbell, 'Access by trust beneficiaries to trustees' documents Information and Reasons' (2009) 3 *Journal of Equity* 97 [134].
802 Tey, 'Trustee's duty of disclosure', above n 800, 220.
803 *Securities and Futures Act* (Singapore, Cap 289, 2006 rev ed).
804 *Trustees Act* (Singapore, Cap 337, 2005 rev ed); *Companies Act* (Singapore Cap 50, 2006 rev ed).

Australian law but as in Australia, there has been confusion as to the clarity of manager and trustee fiduciary duties and their co-existence.

Singapore Business Trusts (typically special purpose vehicles for property development) regulation partly follows the Australian MIS RE model (directors of the Australian corporate trustee owe fiduciary duty to it, and a best interest duty to unit holders), and is similar to the Australia SLE proposal.[805] It also has similarity with Australian superannuation entity trustees whose fiduciary duty is also owed to the beneficiaries 'to [ensure] that fiduciary responsibility towards unitholders of a business trust is clearly placed on a single entity',[806] being the trustee-manager. This is not the case for CIS (real property or securities), resulting in Business Trust unit holders having more fiduciary protection than those in CIS which retains the traditional split trustee-manager model. In Singapore, the distinction in regulation is whether the trust is an active or managed one. This distinction was to facilitate cross-border investment.[807] Unitholders in registered actively managed business trusts enjoy limited liability as if the entity were a company. This is not necessarily the case in Australia.[808]

9.1.2 Limited Liability Partnerships

LLPs are used globally (Australia excepted) as the preferred corporate structure for hedge fund and private equity investing. Singapore[809] draws from the US (Delaware) and UK: 'a modern company law and regulatory framework for Singapore which accords with global standards and which will promote a competitive economy'.[810]

LLPs typically have a general partner (supervisor) and limited partners (investors). The general partner is normally a company. Singapore law is a hybrid of Delaware partnership law with the benefits of limited liability for the partners and UK company law (the preferred UK LLP legal basis). Singapore LLP law provides for: 'complete shield protection [of general partners] … accordingly protected for tortious as well as commercial contractual obligations in the course of business',[811] with the benefits of perpetuity afforded as if the LLP were a company.

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805 Australian Government, CAMAC, above n 23.
806 Lee Suet Fern, 'Real Estate Investment Trusts in Singapore — Recent Legal and Regulatory Developments and the Case for Corporatisation' (2010) *22 Singapore Academy of Law Journal* 36, 57.
807 Ibid 65.
808 Nuncio d'Angelo, *Commercial Trusts* (LexisNexis Butterworths Australia, 2014) 149 [3.98].
809 *Limited Liability Partnerships Act 2005* (Singapore).
810 Yeo Hwee Ying, 'Nature and Liability Shield of Limited Liability Partnerships in Singapore' (2007) 19 *Singapore Academy of Law Journal* 409.
811 *Limited Liability Partnerships Act 2005* (Singapore) s 8; ibid 415.

Singapore follows Australia,[812] asserting partnership fiduciary duty, with creation of an institutional constructive trust over property belonging to a partnership. The test is: 'a corporate opportunity which there was a "real or substantial possibility" of the partnership pursuing, having regard to its existing business activities and its stated aspirations'.[813] Presently, there is no definitive Singapore fiduciary law on this point.[814]

9.2 NBFEs in Germany

The D-REIT was introduced in 2007.[815] D-REITs follow the legal intent of other jurisdictions, including Australia particularly in respect of taxation, but are not trusts in the German or common law context. They are companies (*Aktiengesellescháften*) with their shares listed on a European securities trading market and normally subject to German statutes.

The German equivalent of the LLP, used widely around the world (not Australia) is GmbH & Co KG. This is a combination of a private company not able to offer its shares to the public *(Gesellschaft mit Beschänkter Haftung*) and a limited partnership (*Kommanditgesellschaft*). The KG owns the assets and the GmbH participates as the general partner, usually with identical shareholders.[816] LLP structures confer tax pass-through as in a traditional partnership but with limited liability conferred by the company as general partner.

Alternative investment funds partiality for:

> self-regulation measures and industry co-regulation are likely to be more effective, given the complexity and range of activities pursued by private equity funds, than direct regulatory intervention.[817]

They attracted considerable public criticism *(Heuschrecken*).[818] New pan-EU regulation (Alternative Investment Fund Managers Directive)[819] replaced earlier self-regulation of hedge and private equity

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[812] *Guy Neale v Nine Squares Pty Ltd* [2015] 1 SLR 1097.
[813] Pearlie Koh, 'Agency and Partnership Law' (2014) 15 *Singapore Academy of Law Journal Annual Review of Singapore Cases* 39, 45 [3.18]
[814] Ibid 46 [3.22].
[815] Constantin M Lachner and Rafael von Heppe, 'The Introduction of Real Estate Investment Trusts [REITs] in Germany' (2007) 8 *German Law Journal* 133.
[816] Susanne Kalss, 'The Austrian GmbH & Co. KG' (2007) 8 *European Business Organisation Law Review* 93.
[817] McCahery and Vermuelen, 'Private Equity and Hedge Fund Activism', above n 100, 537.
[818] Locusts [author's trans].
[819] *Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010* [2011] 61/8.

funds[820] favoured by the industry. This Directive applies to 'all EU-based fund managers managing EU and non-EU alternative investment funds, to non-EU funds managers managing EU funds, and to non-EU funds managers marketing EU or non-EU based funds within the EU'. Custodians (depositary) duty includes the 'monitoring of cash flows'.[821] (Australian custodians do not have this responsibility). Other requirements include limitations on leverage, minimum capitalisation of the fund manager, and disclosure of portfolio interests.[822]

9.3 NBFEs in Canada

Collective investments in Canada, like Australian MIS, are often structured as trusts with their units publicly quoted. These trusts follow international typology including C-REITs, Infrastructure Trusts, Energy Trusts, and Business Trusts. Their corporate governance is controlled by both federal[823] and provincial corporations law, being a choice of 14 jurisdictions. They are also subject to trust law administered federally and by the Canadian provinces. '[N]ear uniformity has been achieved across the jurisdictions' corporate codes'.[824] Uniformity is not necessarily achieved in the construction of private trusts including those with publicly traded securities. So Canadian jurisdictions provide unique insight into 'What choices would corporations make it given unfettered freedom to choose their governing law?[825] Australian law assumes the central importance of market consistency.

Canadian empirical analysis of 4675 trust deed provisions of 187 listed unit trusts demonstrates otherwise. 'Canadian corporate law follows the normative prescription that the law ought to provide the rules that parties want.'[826]

> On some dimensions DOT's [individual declarations of trust] mimic the CBCA [*Business Corporations Act, Canada*], but on other important dimensions, particularly remedial ones, they depart significantly from the CBCA.[827]

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[820] *Corporate Governance Guidelines for the Management of Privately Held Companies* (European Venture Capital Association, 2005), cited in McCahery and Vermuelen, 'Private Equity and Hedge Fund Activism', above n 100, 561.
[821] Ferran, above n 609, 401.
[822] Jennifer Payne, 'Private Equity and Its Regulation in Europe' (2011) 12 *European Business Organisation Law Review* 559, 579.
[823] *Business Corporations Act 1985* (Canada).
[824] Anita I Anand and Edward M Iacobucci, 'An Empirical Examination of the Governance Choices of Income Trusts' (2011) 8(1) *Journal of Empirical Legal Studies* 147, 154.
[825] Ibid citing Douglas J Cummings and Jeffery G MacIntosh, 'The Role of Interjurisdictional Competition in Shaping Canadian Corporate Law' (2000) 20 *International Review of Law and Economics* 141.
[826] Ibid 149.
[827] Ibid.

Canadian collective investment schemes structured as trusts are not necessarily governed by corporate statutes (although their corporate trustee is). Trust law principles apply, but 'the notion that [private parties can contract out of default trust law obligations (including their fiduciary duties) has taken hold in common law jurisdictions, including Canada'.[828] As in Australia a Canadian trust can have a corporate trustee with differing standards of duty between a trustee and a director appointed under the *Business Corporations Act*. In the analysis, 63% of the sample had a corporate trustee and 71% did not follow trustee independence requirements.[829] Trust standards are more onerous than the statute and are similar to Australian superannuation trust law, requiring the care, diligence, and skill of a reasonably prudent trustee.[830] Other standards of trustee behaviour are considerably lower than the corporate statute, including poison pill provisions in trust deeds, compulsory buy backs at fair market value of issued units, and unit holder rights of derivative action, although this has attracted judicial attention.[831]

> The evidence is that a significant number of firms opt out of mandatory corporate rules when allowed the choice. This is inconsistent with the market consistency hypothesis.[832]

Neither is it consistent with German Corporate Governance Code research. It is consistent with the Law Matters thesis[833] where jurisprudence underpins a competitive economy and the presumption that the law can facilitate economic development and not simply coerce, regulate and control.[834] In contrast, Australia has market consistency.

9.4 Trusts as commercial entities in the United States

Unlike Australia or the UK (where it is rare for a trust to operate as a commercial trading entity), American trust law has evolved alongside corporations law, 'resulting in a degree of alignment between company and trust law.'[835] A 'common ancestry'[836] from the English Joint Stock company

[828] Ibid 148 citing Anthony Duggan, 'Solicitors' Conflict of Interest and the Wider Fiduciary Question' (2007) 45 *Canadian Journal of Business Law* 414. See also *Hospital Products Ltd v US Surgical Corp* [1984] 156 CLR [72] (Mason, Gibbs, Dawson JJ).
[829] Ibid 156.
[830] Ibid 157.
[831] *Silber v DDJ High Yield Fund* (2006) 20 BLR (4th series) 134.
[832] Anand and Iacobucci, above n 824, 161.
[833] Brian R Cheffins, 'Corporate Law and ownership structure: A Darwinian Link?' (2002) 25(2) *University of New South Wales Law Journal* 346 [2] citing Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (Macmillan, 1932).
[834] Justice Michael Kirby, 'The company director: past, present, and future' (Speech delivered at the Australian Institute of Company Directors, Tasmanian Division, Hobart, 1998).
[835] Nuncio D'Angelo, 'The CAMAC Report on managed investment schemes: Another opportunity missed?' (2012) 23 *Journal of Banking and Finance Law and Practice* 253, 265.
[836] Ibid 266.

(in effect a unit trust) but a different evolutionary path in the US. In the US, functional purpose has primacy over legal form resulting in a commonality of equitable and statutory formulations. This legal convergence provides a useful evolutionary model for Australian NBFEs structured as trusts.

CHAPTER 6: A REGULATORY ARCHITECTURE FOR 21st CENTURY AUSTRALIA: STRATEGY AND TACTICS

Empowering the financial consumer

1. THEMES IN LAW REFORM

Chapters 2–5 address the research questions. This chapter is directed at remedying the primary causes of systemic failure in Australian law identified in answering those questions. It sets out four strategic reform themes supported by specific tactical interventions. This thesis addresses deficiencies in the law and proposes strategic re-order of Australia's regulatory architecture. Both typologies are required for effective implementation: statutory amendment alone will not suffice. The qualitative research suggest that some stakeholder support would be forthcoming.

Australia has arguably benefited from its market based regulatory system and progressed toward its first objective of an entrepreneurial wealth creating society competing with its global peers, the second objective, being financial stability and risk mitigation, has for many people been an abject disaster.[1] These proposed reforms balance entrepreneurial market conduct with investor and beneficiary risk mitigation.

It is a system-wide view. It is doctrinal, requiring absolute obedience to the spirit of the law to reflect community expectation of fiduciary trust and loyalty. It removes incentives for malfeasance and improves incentives for lifting standards rather than reliance on proscriptive and prescriptive box-ticking compliance alone. Reform is designed to enhance financial sector performance for financial consumers and applies to all elements in the investment chain, including its regulators.

1.1 Four strategic themes

The four strategic reform themes are: Re-establishing trust in the investment chain through fiduciary obligation; Related party transactions and conflicts of interest; Architecture for implementation at the financial consumer level — financial planning and wealth management as a profession; and Market conduct regulation for the 21st century.

[1] See above ch 1 s 6.

1.2 Tactical support

Within each reform theme tactical support to remedy failures in disclosure, develop Australia as a world financial centre, and NBFE governance are essential for successful implementation.

1.3 Investors and beneficiaries as financial consumers

This reform strategy is designed to be financial consumer-centric, not supplier or regulator centric. Financially independent retirement for Australians is a pipe-dream if that focus is compromised. Consumer empowerment through improved financial literacy and destruction of power imbalances in the investment chain requires oversight outside of existing supervisory structures. 'An informed, expertly staffed and independent institution evaluating financial regulations and regulatory actions from the public's point of view'.[2] This will allow different views to be heard, not subsumed by existing vested and politicised interests who will regroup and dilute proposed reforms that affect those interests.[3] A specific purpose Reference Group with direct senior ministerial access is required.

Australian reform has not resolved the underlying systemic causes of market conduct failure identified and quantified in this thesis. Implementation will take 'significant time for construction, debate, refinement and implementation'.[4] The qualitative research[5] conducted in Melbourne, Sydney and Brisbane is insightful and proposes strategies consistent with jurisdictions that have better dealt with their own systemic failures. The top decile sources of failure identified by interviewees are: related party transactions, conflicts of interest, accretive statutory tinkering, intrusion of black letter law on trust principles, and box-ticking regulation by the Australian Securities and Investment Commission (ASIC). Extended to the top quartile, this list adds: financial planning not being a profession, self-interest and lack of probity, ineffective leadership at ASIC, Australia's uncompetitive financial landscape, smart lawyer manipulation of complex black letter law, lack of unqualified best interest duty of financial planners, boards needing more independent minds, and flawed financial literacy of advisers.

Future of Financial Advice (FoFA) is 'a tragedy', a 'means of [financial] product distribution'. ASIC 'needs a big shake-up with high calibre people', is subject to 'cronyism' with 'idealogy over-riding

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[2] Stijn Claessens and Laura Kodres, 'The Regulatory Responses to the Global Financial Crisis: Some uncomfortable questions' (Working Paper No 14/46, International Monetary Fund, March 2014) 26 citing James Barth, Gerard Caprio and Ross Levine, *Guardians of Finance* (MIT Press, 2012).
[3] See, eg, M Scott Donald, 'Super needs a better regulator, not more rules' 6 November 2014 *Australian Financial Review* (Sydney) Editorial & Opinion, 55.
[4] Ibid 30.
[5] See above ch 3 tab 3.20; app 1.

facts', 'just doesn't get it', and 'powerless to act against known malfeasors'. These are personal views of the interviewees, but top decile and quartile samples provide holistic support for such excoriating criticism. As does the empirical analysis quantifying investor losses and their causes. The Australian Prudential Regulation Authority (APRA) and the Fair Work Commission (FWC), perhaps because of their much smaller stakeholder groups, were not subjected to such invective despite widespread concerns of political influence and accountability.

Suggested solutions[6] include overwhelming support for a better culture, extension of fiduciary obligation to all parts of the investment chain, financial planners as educators, university standard training for directors and trustees, reform of ASIC's operations, Canadian style Self-Regulatory Organisation (SRO) architecture, and an independent arbiter to reduce reliance on the courts.[7]

Resolution also includes emulation of models and standards from other jurisdictions which themselves have dealt with similar systemic failures. There are examples where professional and industry associations are quasi-regulators working from the bottom up, educative and consultative, thereby reducing inexhaustible demands for market conduct services from the central regulator, making for more effective 'Responsive Regulation'.[8] Scholarly research has demonstrated the difference between compliance based cultures and values based cultures and how 'assumptions of rationality in economic theory are contradicted by experimental evidence'.[9] This is important behavioural economics research with global multi-jurisdictional implications[10] but receiving only limited scholarly attention in Australia.

The basis of necessary infrastructure exists in Australia today. *Ipso facto*, ASIC can become ex ante and supervisory rather than ex post and reactive, its present posture impractical even with huge additional resources. It can evolve to apply the lessons of Cooper and Heydon. Behavioural economics scholarly research supports this change in posture, regarding ex post strategies as 'behaviourally dysfunctional' requiring a 'counterintuitive shift of rule-making competencies: from public to private ordering.'[11] In effect, Responsive Regulation, presently given lip-service rather than

[6] From greater than 50% of respondents in each city.
[7] Administrative Appeals Tribunal and Takeovers Panel were cited as examples.
[8] Dimity Kingsford Smith, 'A harder nut to crack? Responsive Regulation in the financial services sector' (2011) 44(3) *University of British Columbia Law Review* 695, 702.
[9] Don Mayer, Anita Cava and Catharyn Baird, 'Crime and Punishment (or the Lack Thereof) for Financial Fraud in the Subprime Mortgage Meltdown: Reasons and Remedies for Legal and Ethical Lapses' (2014) 51(3) *American Business Law Journal* 515, 534 citing Dan Ariely, *Predictably Irrational: The Hidden Forces That Shape Our Decisions* (Harper Perennial, 2010).
[10] Mayer, Cava and Baird, above n 9, 541.
[11] Sven Hoeppner and Christian Kirchner, 'Ex Ante versus Ex post Governance: A behavioural perspective' (2016) 12(2) *Review of Law and Economics* 227.

practical implementation. '[I]t is doubtful whether [ex post] monitoring can be done cost effectively'.[12] Evolution to an ex ante Responsive Regulation model requires discipline in those that implement it. The Damoclean Sword over improper conduct is to be provided by fiduciary obligation in the investment chain enforced by effective regulators.

[12] Ibid 231.

2. ITINERA FIDUCIAE

Re-establishment of trust in the investment chain

'We are never so vulnerable than when we trust someone'.[13] Investment requires trust. Fiduciary obligation is the mirror of community expectation of trust in those that advise them or manage their funds. 'Fiduciary law cannot be subsumed under contract … a violation of fiduciary duties carries a "moral taint". … Unlike contract, trust is a moral relationship; its unwarranted violation is a moral principle'.[14]

In Australia, there is a trust deficit.

> Since an underlying motivation of the imposition of fiduciary obligations is to maintain public confidence in socially important relationships like that of investment, the routine circumvention of such obligations raises public policy concerns.[15]

Fiduciary relationships can and should be found at every point in the investment chain where there is discretion, information, reliance or advice. The need is to re-establish foregone trust, confidence and respect in fiduciaries required to act as if they should be trusted. This outcome is unlikely to be achieved with prescriptive administrative regulation. It is 'not just a policy choice, but an architectural choice about how our law fits together'.[16] The economic interests of investors and beneficiaries supported by holistic fiduciary standards in the investment chain is a different proposition from compliance with regulation. In the UK, as in Australia, it has led to a different result: creative compliance, regulatory arbitrage, creeping corruption. It also leads to different approaches to conflicts of interest. Identifying, disclosing and managing conflicts of interest in a complex investment chain controlled by multiple intermediaries is incompatible with the concept of a fiduciary having stewardship of client property if that fiduciary may have a conflict of interest.

Investor and beneficiary expectations (with statutory support in superannuation best interest law) include the optimisation of their value outcomes. What they typically attain, especially in managed investment schemes (MIS) are contractual rights or legal interests. The economic consequences to the Australian economy are significant. Australia is not unique, but of the comparative jurisdictions

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[13] Chan Sek Keong, 'Trusts and the rule of law in Singapore' (2013) 25 *Singapore Academy of Law Journal* 365.
[14] Richard Holton, 'Fiduciary Relations and the Nature of Trust' (2011) 91 *Boston University Law Review* 991, 994 quoting Tamar T Frankel, *Fiduciary Law* (Oxford University Press, 2011) 238.
[15] Andrew Tuch, 'Investment Banks as Fiduciaries: Implications for Conflicts of Interest' (2005) 29 *Melbourne University Law Review* 478, 516.
[16] Joshua Getzler, '"As If" – Accountability and Counterfactual Trust' (2011) 91 *Boston University Law Review* 973, 988.

studied, it has made the least progress addressing systemic problems in financial services and financial products regulation. When considering the re-establishment of trust, other jurisdictions follow one of two paths: (a) accretive statutory reform, or (b) the application of behavioural economics theory to regulation, leading to ex ante industry based regulation underpinned by universal fiduciary obligations.

Presently, Australia, the UK, and the US pursue accretive statutory reform, whilst Canada, Germany (with EU overlay), apply different legal mechanisms reflecting their different legal traditions. These are not without criticism.[17] Singapore pursues a culturally nuanced approach drawing upon legal tradition but implements German fiduciary- like standards of responsibility.

The application of behavioural economics research to financial regulation provides the theoretical basis for the imposition and extension of fiduciary principles to financial products and services. Each country has produced different but insightful results. There is recognition of the difference between compliance and values in Australian cases.[18]

Funds management entities, including promoters, and their directors are fiduciaries, although some 'major investment banks have indicated publicly their belief that they operate unconstrained by fiduciary obligations'.[19] Where managed investment schemes (MIS) are contractual rather than express trusts, that does not exclude the application of fiduciary principles, and a court may treat the relationship 'as fiduciary under established principles of equity'.[20] There is a tension between statutory prioritisation and fiduciary prohibitions, the result being whether an investment bank or funds manager 'is obliged by fiduciary principles to avoid positions of conflict…',[21] or not. Fiduciary relationships can be created by reasonable expectation where the client relies on the advice

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[17] Lisa Zhou, 'Fiduciary Law, Non-Economic Interests and Amici Curiae' (2008) 32(3) *Melbourne University Law Review* 1158.
[18] See, eg, *Australian Securities and Investments Commission v Bridgecorp Finance Ltd* [2006] NSWSC 836 [17] Barrett J citing *Australian Securities and Investments Commission v Mauer-Swiss Securities Ltd* [2002] NSWSC 684 Palmer J: '[I]t would have been folly on the part of the legislature to attempt to define or limit what interests should be protected or how: to do so would have been to ignore the sad reality that the ingenuity of fraudsters inexhaustible, their snares for the gullible pitiless and of infinite variety...'
[19] Tuch, above n 15, 479.
[20] Pamela F Hanrahan, *Funds Management in Australia: Officers Duties and Liabilities* (LexisNexis Butterworths, 2007) 52.
[21] Tuch, above n 15, 488.

proferred.[22] Presently for wholesale investors in Australia, that relationship can be avoided by contract.[23] For retail investors, it is subsumed by the *Corporations Act*.[24]

Fiduciary standards mitigate malfeasance by reducing the power imbalance resulting from asymmetries of knowledge and comprehension. They align interests. Fiduciary law is more than 'legal polyfilla'[25] requiring legitimate and reasonable client expectations of best interest to have primacy over contract. So who is categorised as a fiduciary has considerable importance to the investing community. '[A]ll of these are bound to the investor-beneficiaries by a web of fiduciary relationships both orthodox as well as unusual'.[26] In a consolidating Australian NBFE market, these multiplicity of responsibilities are likely to become more widespread.

This single question of financial consumer trust in the investment chain should determine all future policy development and implementation. This includes financial literacy (presently the role of ASIC), the future of financial services and financial products provision. Capital markets for SME's to increase industrial productivity and skilled employment, retirement incomes, and Australia's future as a world financial centre substantially rely on it.

2.1 Whither Australia?

Australian law has uncertain interpretation of the fiduciary status of best interest duties.[27] If Australian NBFE directors were themselves subject to *untreue* doctrine (in its proscriptive and prescriptive formulations), supreme rather than subordinate, they would be less likely to hide behind transactional based disclosure requirements governed by statute and contract. The need to apply fiduciary law to investment banks (in their various formulations as financial conglomerates) has long been recognised in Australia.[28]

The future of trust rests upon fiduciary principles: these need the legal support of *culpa in contrahendo* and *untreue* standards. As judicially recently interpreted in Australia, fiduciary principles, compromised as they are by statute and contract, have not been sufficient to deter

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[22] *Commonwealth Bank of Australia v Smith* [1991] 42 FCR 390 (Davies, Sheppard, and Gummow JJ); *Aequitas v AEFC* [2001] NSWSC 14 (Austin J).
[23] Tuch, above n 15, 500–502.
[24] *Corporations Act 2001* (Cth) ss 961A, B.
[25] *Fiduciary Duties of Investment Intermediaries* (Law Commission UK, Paper No 350, 30 June 2014) [3.1].
[26] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windso*r [1995] FCA 1663 [58] (Finn J).
[27] See above ch 4 s 2.5.
[28] See, eg, Tuch, above n 15.

malfeasance. Where there have been green shoots of more enlightened interpretation,[29] judicial reticence seeks to limit their broader application.

The deterrent effect of fiduciary law will require two components: these are (a) prohibition not prioritisation by informed consent; and (b) prescriptive and positive duties to include financial best interest, improved disclosure and education of the client to at least *culpa in contrahendo* standard. Informed consent should not be 'a merely formal process'.[30] That is to say, the implementation of the SRO model requires financial advisers to tutor their clients as they advise them. It also means transferring financial literacy statutory responsibility from ASIC to the SROs through reform of the *ASIC Act*. This evolution is theoretically, culturally and organisationally sound. It has a scholarly basis in behavioural economics research, increases the financial literacy of the community, and provides the human resources ex ante at the interface when and where they are needed.

The imposition of statutory fiduciary duty directly in the investment chain has not been previously viewed with undiluted pleasure:

> the controversial suggestion … that the duty of directors to their 'company' can itself embrace some level of fiduciary responsibility to the beneficiaries of a trust of which their company is a trustee … is questionable … whether this heralded development in our law is as desirable or necessary one in the trust company context.[31]

However, 'superannuation entity director' is now enshrined in the *SIS Act* with direct fiduciary obligations to the beneficiary,[32] and in the *Corporations Act*[33] for MIS securities holders.

As Heydon[34] also notes, cultural change to ensure 'reasonable expectations'[35] of fiduciary obligations and principles is a generational task. That loyalty to others, enshrined in the general law but subsumed by statute and contract, should require reinforcement is a sad reflection on the efficacy of Parliament. It is a public policy issue to enforce effective disclosure, require effective conflicts avoidance and balance information and vulnerability asymmetries between provider and client.[36] Judicial and

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[29] *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64 [100] (Gibbs CJ, Mason J).
[30] Getzler, above n 16, 989.
[31] *Australian Securities and Investments Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Pty Ltd and Peter Grenfell Windsor* [1995] FCA 1663 [77]–[78] (Finn J).
[32] *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Cth) Explanatory Memorandum [1.33].
[33] *Corporations Act 2001* (Cth) ss 601FD, 601FC.
[34] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report* (December 2015) (Commissioner Heydon) ['Heydon'].
[35] Tuch, above n 15, 483.
[36] Ibid 505.

scholarly opinion appears to be open to further evolution of the law in questions of loyalty. Successful evolution of the Triple Peaks model of regulation and supervision will rest upon it. Triple Peaks is the interface between the financial, savings and industrial systems.

Law reform requires: (a) simplification and harmonisation of the various statutes; and, (b) renewed focus on fiduciary principles of propriety, honesty, and uncompromised loyalty. 'The fiduciary obligation is a demanding standard of propriety in conduct that is unequalled elsewhere in the law',[37] requiring 'complete loyalty to the service of another's interests'.[38] Any discussion of law reform needs to comprehend these two themes. The first imperative is better understood by reflecting on analysis of international practice in comparable jurisdictions. The second imperative will require a national sustained education campaign over a sustained period to inculcate industry participants in director, trustee, and officer roles with these fiduciary concepts.

Presently in Australia, comprehension and application of fiduciary principles is not widespread, given lip-service, often ignored, eliminated in contract, and subservient to adherence to specific statutory provisions. Compliance with the letter of the law but not adherence to its spirit or community expectation. Canada and Germany have dealt with this problem applying their respective fiduciary and civil law duty of care standards. There is a public policy question as to whether Australian statutes 'adequately protects those to whom the general law would grant protection, if enforced, afforded by the fiduciary relationship'.[39]

2.2 How statutes reduce regulatory efficacy: subsuming of fiduciary principles by statutory accretion

A common theme from 1981-2018 has been an increase in the number of statutes and a large increase in their provisions. Resulting complexities have given rise to significant and recurring judicial

[37] Ibid 479 citing *Bristol & West Building Society v Mothew* [1998] Ch 1 [16] (Millett LJ).
[38] Ibid 481 citing P D Finn, 'The Fiduciary Principle' in T G Youdan (ed), *Equity, Fiduciaries and Trusts* (Carswell, 1989) 1, 27.
[39] Ibid 514.

frustration.[40] Empirical analysis demonstrates that the ‘Age of Statutes’[41] has not prevented, in any meaningful sense, an elimination of systemic problems nor of their cyclical recurrence: they may have added to the problem.[42] This has created a large compliance industry with attendant increasing direct and indirect costs, to be borne either by beneficiaries and investors, and/or market consolidation in attempts to capture economies of scale. Statutory evolution has been and remains politically contested, its effectiveness reduced as lobby groups pursue their particular interests. Similarly, misuse of ‘fiduciary’ the adjective by politicians and lobby groups has resulted in a mismatch of community expectations based on common usage and the legal reality of fiduciary law in Australia.[43]

A second common theme is the relegation of fiduciary law to outlier status. Principles based general law has often provided the basis for the resolution of many specific NBFE cases. ‘Each of statute and equity influences the other [although] there is no judicial power to sunset some statutes’[44] as there is in the common law. In the meantime,

> It is ironic, then that those same political processes that are privileging these nobler qualities [of fiduciaries] are in fact de-coupling the regulatory regimes from the general law antecedents in which those qualities were initially expressed. Political processes are ensuring that what the law expects of Mason J’s quintessential fiduciaries, or at least those whose activities encroach on areas of public policy, are regulated by multi-layered, highly specific, bespoke regulatory regimes that largely eclipse the proscriptions and prescriptions of the general law.[45]

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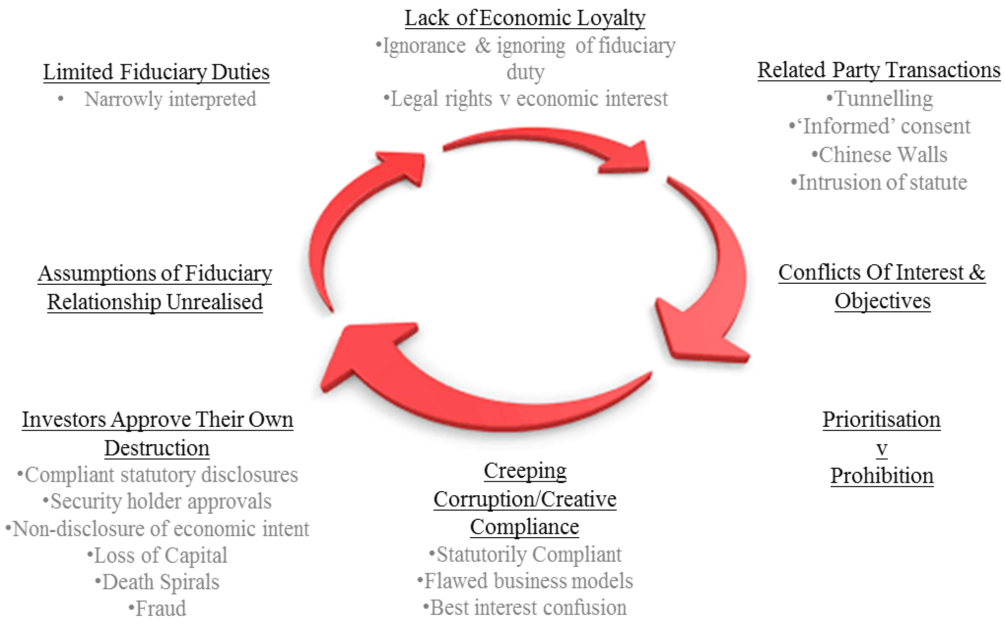
[40] See, eg, *ASIC v Vine*s [2006] NSWSC [14] (Austin J): ‘The application of the statutory language is difficult, because of the very wide range of activities conducted in corporate form’. Rares J succinctly expressed his frustrations with statutory accretion in *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq*) [2012] FCA 1028 (Rares J) noting the *Corporations Act* and *ASIC Act* have lengthy and different definitions of financial services and financial products: he questions the costs of statutory complexity to the community, see ch 4 s 4.1.1. S 62 of the *SIS Act* is ‘complex, clumsy and lacks clarity … it takes over 900 words to say that a superannuation fund must be set up to provide benefits …’ quoted in Anthony Asher, *Superannuation ‘objective’ likely to be captured by industry* (The Conversation, April 2016), <https://the conversation.com>.
[41] Mark Leeming, ‘Equity: Ageless in the “Age of Statutes”’ (2015) 9(2) *Journal of Equity* 108.
[42] See above, ch 3, tab 3.25.
[43] M Scott Donald, ‘Regulating for fiduciary qualities of conduct’ (2013) 7(2) *Journal of Equity* 142 [1].
[44] Leeming, above n 41.
[45] Donald, ‘Regulating for fiduciary qualities of conduct’, above n 43, 142 [2].

FIGURE 6.1 SYSTEMIC FAILURE IN AUSTRALIAN LAW



Accretive statutory change is not enough. Whilst 'we now live in an age of statutes and not of the common law,'[46] it is not statute that has eliminated systemic failures and their cyclical manifestations. 'complying merely with the regulatory requirements may well leave the investment bank in breach of the fiduciary obligation'.[47] Cyclical corruption rooted in cultural mores[48] requires excision, not management. This requires a rethink of assumptions of robustness in statutory construction,[49] and of the embracing of 'principles drawn from the law of trusts and from fiduciary law...'[50] In economics terminology, there is market failure: 'These problems are at the core of the structure of the financial markets'.[51]

In many cases, contracts mean that fiduciary expectations are not legitimate…'[52] particularly in Australian NBFEs. Judicial reticence to interfere in arms-length contracting parties[53] where best

[46] Paul Finn, 'Public Trusts, Public Fiduciaries' (2010) 38 FLR 350.
[47] Tuch, above n 15, 516.
[48] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 34.
[49] Finn, 'Public Trusts, Public Fiduciaries', above n 46.
[50] Ibid 335.
[51] Tuch, above n 15, 516.
[52] *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 25, [8.48].
[53] *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64 [100]–[102] 71 (Gibbs CJ, Mason, Wilson, Deane and Dawson JJ) citing *Paul Dainty Pty Ltd v National Tennis Centre Trust* (1990) 22 FCR 495, 515–516.

interest of clients are contractually overridden does not assist the vulnerable to mount equitable challenges to malfeasance.

> Even where the relationship is contractual (as it normally will be), the matter is too important to be left entirely to the agreement of the parties and the interpretation of that agreement … A too casual failure to recognise the requirements of a fiduciary position, and sometimes a short sighted assumption that all relevant duties are prescribed in contract, can be and has been responsible for serious misbehaviour in the financial markets and elsewhere, as shown by many litigated cases in the last quarter-century.[54]

Assuming that statutory regulation alone can drive market behaviour is problematic. In practice, as in Canada and Germany, the intertwined European and national jurisdiction mix of misnamed soft law through self-regulation, co-regulation, and government regulation, disciplined by the primacy of fiduciary principles and the statutory powers of minority shareholders has resulted in 'Firms begin to avail themselves of corporate governance principles codes, guidelines and laws, thereby leaving the "box-ticking" phase behind'.[55] This is a salutary lesson for present Australian practice, its *Corporations Act* facilitating creeping corruption in MIS and other NBFEs through box-ticking compliance.

The disconnection between community expectation and legal reality needs to be addressed. Community assumptions of fiduciary obligation of economic loyalty to investors by professional persons with whom they deal is not fact. FoFA reform has resulted in investor exposure to adviser compliance with statutory process, incomprehension of the legal difference between an employee and an authorised representative, inability to obtain general law remedy and exclusion of those not categorised as retail investors. This disconnection can be remedied by community financial literacy education and, as was proposed in the UK and practised in other jurisdictions, by revisiting the extent, nature, and content of fiduciary obligations. The exposure of the legal reality will mean further community anger.

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[54] *Fiduciary Duties of Investment Advisers* (Law Commission UK Consultation Paper No 215, 22 October 2013) 171 citing Peter Watt (ed), *Bowstead & Reynolds on Agency* (Sweet & Maxwell, 19th ed, 2010) [6–043].

[55] Joseph A McCahery and Erik P M Vermuelen, 'Private Equity and Hedge Fund Activism: Explaining the Differences in Regulatory Responses' (2008) 9 *European Business Organisation Law Review* 535, 537.

2.3 Clarity in law: harmonisation of best interest duty

There are five interpretations of best interest in the *Corporations Act*,[56] two in the *SIS Act*,[57] a traditionally lesser duty in the *Fair Work (Registered Organisations Act)* (now amended) as well as general law interpretations, fiduciary or otherwise, which add to the confusion.[58] Whilst these interpretations are contextual they are, with limited exceptions, statutorily undefined. The community, and directors responsible to it in the performance of their duties, should not be expected to comprehend these nuances, for the most part determined in the general law.[59]

[56] *Corporations Act 2001* (Cth) ss 180-4, 601 FC (1), 601 FD (1)(b), 961B(1)(2).
[57] *Superannuation Industry (Supervision) Act* 1993 ss 52(2), 52(8), VN(a)–(b).
[58] See, eg, *ASIC v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liquidation) (Controllers appointed) (No 3)* [2013] FCA 1342 (12 December 2013) [463] (Murphy J), *Lewski v ASIC* [2016] FCAFC 96 [347] (Greenwood, Middleton, and Foster JJ), *Lewski v ASIC (No 2)* [2017] FCAFC 171 [190] (Greenwood, Middleton, and Foster JJ) [‘Prime Trust’].
[59] See, eg, ch 1, s 11.

TABLE: 6.1 DIFFERING INTERPRETATIONS OF BEST INTEREST IN AUSTRALIAN LAW

Source of law	**Authority**	**Application**	**Interpretation**
Corporations Act	s 181	Company	Good faith & proper purpose; Objective
Corporations Act	s 180(2)(d)	Company	Rational belief; Subjective
Corporations Act	ss 601FC(1)(c), FD(1)(b)	MIS	Best interest of scheme members
Corporations Act *Corporations Act* *Corporations Act* *Corporations Act*	ss 961A,B(1),(2) s 766E [New] Ch 8B [New] Ch 8B	Financial advice client Custody of assets Member Depositary as fiduciary	Compliance with process; safe harbour defence Director to give member priority Depositary to act in best interests
SIS Act	ss 52 (2), (8)	Trustee	Personal liability for s 52 covenants
SIS Act *SIS Act*	s 29VN (a),(b) s 10	Beneficiary (My Super) Custody	Best long term financial interest
Fair Work (RO) Act	s 382 (amended 2016)	Company	Qualified by belief as to best interest; Subjective; amended as CA
General law	*Prime Trust*	Directors	Uncertain boundary of best interest duty
General law	*NSG Services*	Financial advice client	Not addressed
General law	*Pioneer Concrete Services*	Interests v best interests	May be different or the same

General law	*Gladstone Pacific Nickel Limited*	Interests	Of the company as a whole, not creditors only
Fiduciary law	*Rouse v IOOF*	Undivided loyalty to trust	Trust and beneficiary best interests may diverge
Fiduciary law	*Cowan v Scargill; Nestle v National Westminster*	Undivided loyalty to beneficiaries of trust	Procedural elements; Best financial interest; objective test; judged ex ante based on needs
Fiduciary law		Custody of assets	Differing interpretations of custodial trustee duties

Best interests in these statutory formulations apply general law phraseology, itself of variable interpretation. This uncertainty is compounded by the more recent extension of superannuation covenants to directors of their corporate trustees personally, hence the need of trustee directors to pay homage to the boundaries of the general law. '[T]he case law directly interpreting and applying the relevant provisions is scant'.[60] An important distinction between the duties of a superannuation entity trustee and a Responsible Entity (RE) MIS director's duty (where trust principles have been subsumed by statute and contract) is that trustees are 'required to engage with the issues they face, and not merely to ensure they have a pre-defined process has been followed accurately, or in the vernacular, that all the boxes have been ticked'.[61] '[T]he RE model emphasises the importance of "compliance" arrangements … quite different from "performance" and it is worth examining whether an independent trustee (or other) model would provide greater oversight and be better at resolving inherent conflicts of interest'.[62] This would return Australia to something akin to pre-1998 regulation.

Performance and appropriateness are both important where there is no statutory definition of investment strategy.[63] Directors best interest duties are severely compromised by lack of development of the law of what constitutes investment strategy, its deficient relationship with modern portfolio theory and practice, and the interface with investment jurisdictions that have developed the law. This

[60] Pamela F Hanrahan 'The relationship between equitable and statutory "best interests" obligations in financial services law' (2013) 7(1) *Journal of Equity* 46 [V].
[61] M Scott Donald, 'Prudence under pressure' (2010) 4(1) *Journal of Equity* 44, 51.
[62] Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern failure' (2010) 2 *The Finsia Journal of Applied Finance* 27.
[63] Donald, 'Prudence under pressure', above n 61, 53.

affects decisions on inward outward capital flows. It puts directors at jurisdictional risk. There is a similar lack of definition of what constitutes a defence in due diligence.

2.4 Fiduciary and non-fiduciary doctrines: a comparison

TABLE 6.2 EXAMPLES OF COMPARATIVE FIDUCIARY AND FIDUCIARY-LIKE DUTIES

Jurisdiction	Posture	Fiduciary duty	Fiduciary-like provisions	Statute
Australia	General law proscriptive;	Advisers can contract out;		
Australia	*SIS Act* proscriptive with prescriptive statutory extensions;	Directors party to superannuation trustee covenants; Directors best long term financial interest (superannuation beneficiaries)		*SIS Act* ss 52A(2), (6), 29VN;
Australia	*Corporations Act* proscriptive unless informed consent			*Corporations Act* s 180
Australia	*Corporations Act*	MIS members; Scheme (a trust)	Financial advice to retail clients; prescriptive procedure for advisers; safe harbour	*Corporations Act* ss 961A,B

Australia	*Corporations Act*		Interests of MIS members have priority	*Corporations Act* ss 606FD, FC
Australia	*Corporations Act*	Constitution as a statutory contract; Depositary status based fiduciary		[New] Ch 8B
Australia	*Fair Work (Registered Organisation) Amendment Act*	Members of the organisation	Director nexus directly with Member; Duty of good faith; 'belief' replaced (former s 382)	*Fair Work (Registered Organisations) Amendment Act s 290*
Singapore	Proscriptive	No statutory duty client financial advice; Business Trusts for actively managed CIS;	Licensing of investment chain; Directors duties; Fair Dealing; Reasonable & appropriate test; Personal liability; Separation of trustee in CIS; Best interest of company	*Consumer Protection (Fair Trading) Act;* *Companies Act* s 157C; *Financial Advisers Act* s 27; *Securities and Futures Act* Cap 289; *Trustees Act* Cap 337;
Canada	Prescriptive, Subjective, Distinctive	Broad contextual concept; Good corporate citizen; Fair dealing; Long term interests (directors – companies); Principles based;	Teachable moments; Client Relationship Model	Canadian Securities Administrators Standard of Conduct; Investment Industry Regulatory Association Rule 29; Mutual Fund Dealers Association Rule 2; 2.1.4;

		Advisers can contract out, but no business judgment safe harbour; Compliance with statutory duties (directors)		*Business Corporations Act*
United Kingdom	General law traditionally proscriptive, evolving to prescriptive intervention	No statutory fiduciary duty for advisers; Duty of care (advisers)	No statutory best interest duty for advisers; Best long term interest (companies)	FCA Handbook conflict of interest provisions; *Companies Act 2006* ss 172-178; Stewardship Code; Senior Management Regime
United States	Prescriptive; Proscriptive;	Investment advisers; Retirement accounts; No Uniform Fiduciary Standard;	Broker dealers;	*Securities and Exchange Act*; *Investment Advisers Act*; *Dodd-Frank Wall Street Reform and Consumer Protection Act*; *Employee Retirement Income Security Act*; *Financial Choice Bill* (unenacted 2017).
Germany	Prescriptive, Proscriptive, Subjective, Objective	Contract, Agency	Untreue (Treu und Glauben, Guter Glaube); Culpa in contrahendo; Unternehmeninteresse	*Aktiengesetz* (Germany) 1965 §§ 88 (1); 93(1), 93(2); 112; *Civil Code (Germany)* 1907 §§31(4), 311(2); 242; *Securities Trading Act* (Germany) 1998 §31d; EU Directive 86/653/EEC; EC Directive 2004/39/EC §19(4)

2.5 Who is to be categorised as a fiduciary?

The objective is to provide clarity in and quality assurance of the investment chain. 'The greater the degree of trust, vulnerability, power and confidence reposed in the fiduciary, the more likely that a reasonable person would have such an expectation.'[64] Who is categorised as a fiduciary therefore is of paramount importance to the community. Historically, 'this is a "notoriously intractable" problem[65]… [a] vague protean ethical standard embodied by the fiduciary obligation…'[66] '[I]t is not easy to attempt to define the circumstances in which a fiduciary relationship will be found to exist,'[67] tests including the degree of mutual trust, confidence, and reliance.[68]

All entities and persons in the investment chain, where not already defined, and where there is reliance, discretion, advice or information used in decisions should be statutorily defined as status-based fiduciaries in the *Corporations Act*, equivalent provisions in the *SIS Act* and *Fair Work (Registered Organisations) Amendment Act*. These entities and persons include all those involved in the process of providing financial advice, investment advice, disclosure documentation and associated promotional materials, responsibility for assets, or discretionary decision making about financial products for clients. Inter alia, commercial banks (where advice is provided), merchant, and investment banks, investment promoters and manufacturers of those financial products, financial advisers, wealth managers, superannuation entity trustees, MIS trustees (REs), custodians, investment researchers, ratings agencies, securities brokers, insurers and their brokers, fund managers, directors and officers of finance companies. Fiduciary status is to be accorded to all directors, officers, employees and representatives involved in client facing activity in the investment chain with statutory personal liability with no power of delegation or liability.

2.6 Fiduciary duties not to be excluded in contract

Contracting out of fiduciary responsibility should be statute limited, otherwise the necessary cultural change can lawfully be ignored. Neither should it be contractually delegated. All contracts between entities and persons in the investment chain to be statutorily required, by amendment to the *Corporations Act* (and similar provisions in the *SIS Act* and *Fair Work (Registered Organisations)*

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[64] *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 25, [3.23] citing J Edelman, 'When do fiduciary duties arise?' (2010) 126 *Law Quarterly Review* 302.
[65] Ibid citing Ernest Weinrib, 'The Fiduciary Obligation' (1975) 25(1) *University of Toronto Law Journal* 1 [5].
[66] Ibid [22].
[67] *News Limited v Australian Rugby Football League Limited v New South Wales Rugby League Limited and Others* [1996] FCA 1256 [312] (Burchett J).
[68] Ibid [312]–[316] (Burchett J).

Amendment Act) to include acknowledgement of the objectives of the investment chain, being for the financial benefit of retail and wholesale clients and beneficiaries. Removal of the safe harbour defence in s 961B(2) of the *Corporations Act* eliminates statutory provision for contracting out of fiduciary duty, consistent with Canadian SRO best interest duty of fiduciaries and Singapore regulation of financial advice.

2.7 To whom should fiduciary duties be owed?

Fiduciary duties are generally owed to the proximal entity or person. These would normally be the recipients of financial advice, investment information, disclosure documents and expert opinions, where reliant upon discretionary decisions, or beneficiaries of third party custody arrangements. In Singapore this is broadened. Licensing whilst not fiduciary, includes any person (gatekeepers) offering advice, research, portfolio influence, have non-public knowledge or access to the portfolio, or is named or referred to in offer documents or marketing material. The practical effect is to quality assure the fund management chain by extension of personal fiduciary-like responsibilities. Circumvention by interposition of entities is prohibited. Similarly, there is statutory inclusion in contract of the objectives of investment and prohibition of disclaimed liability through non-reliance clauses. Statutory support should be provided by extension of consumer protection legislation by reform of the *ACCC Act* following the Singapore example.

Contracts material to the veracity of the investment chain are to be lodged with ASIC with the relevant product disclosure statement (PDS). It is not proposed that ASIC have the powers of the German notary or commercial court (*Handelsgericht*), but as ex ante market conduct supervisor, it should have the power of review, but with greatly improved performance criteria which satisfy commercial time frames.

This combination of tactics, in practice, should ensure Australian NBFEs, their directors and officers, proximal or not, serve the end investor and beneficiary.

2.8 Financial literacy: the confluence of fiduciary doctrine and behavioural research

Financial literacy is the third tenet of the Wallis reforms in Australia, designed to provide market discipline to those providing financial products advice. Empirical data demonstrate that there is a problem with financial literacy in Australia.[69]

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[69] See above ch 2, s 5.8: Expectations measurement of financial literacy reports an alignment of ASIC and stakeholder views (external stakeholders 21%, ASIC 18%, variance -3%). It does not use absolute data. The *Fit for the Future* review concludes that ASIC 'does lead international best practice in advancing broad

Canadian financial advisers, in contrast to Australia do not have a business judgment rule to rely on. It is in the interests of the adviser to assist their client to become financially knowledgeable. 'Positive outcomes for some US financial literacy programs have been attributed more to the advice provided than to simple education'.[70]

> Many of the seemingly successful financial education courses studied to date may actually owe their success not due to the direct content of the information conveyed but due to their collateral consequences, such as individual counsel[l]ing with an instructor…[71]

The Canadian SRO Client Relationship Model lends itself to the concept of financial advisers as fiduciaries being tutors in a symbiotic relationship. It provides the necessary human resource infrastructure with 'skin in the game'. This also reduces paternalist pressures seeking to restrict retail investor access to financial products. The German equivalent is to be found in its civil law *culpa in contrahendo* doctrine being a requirement to not only fully disclose but to ensure financial consumer comprehension. This is the confluence of practical financial literacy education and fiduciary-like duty of care doctrine now codified in German and EU law. It reasserts German paternalist tradition withour reducing investment choices.

Singapore also has paternalist traditions manifested by the codification of equitable principles in consumer protection legislation. The importance of 'teachable moments' is recognised by school-based tutoring using the MoneySENSE platform. The UK recognises the long lead times to develop market disciplinary competencies by financial consumers.[72] The then Financial Security Authority recognised the need for 'collaboration among the public, private, and non-profit sectors,'[73] including the free Money Advice Service. Importantly:

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consumer financial literacy … while the overall financial literacy strategy is comprehensive and world best': Karen Chester, Mark Gray and David Galbally, *Fit for the future: A capability review of the Australian Securities and Investments Commission – A Report to Government* (Report, December 2015). This conclusion needs to be challenged.

[70] Mary Anne Waldron, 'Unanswered questions about Canada's Financial Literacy Strategy: A comment on the report of the Federal Task Force' (2011) 51 *Canadian Business Law Review* 361, 376.

[71] John A E Pottow, 'Financial Literacy or Financial Castigation' [2011] 51 *Canadian Business Law Journal* 394, 402.

[72] *Building Financial Capability in the UK* (Financial Services Authority, Financial Capability Steering Group, 2004).

[73] Saul Schwartz, 'The Canadian Task Force on Financial Literacy: Consulting without listening' [2011] 51 *Canadian Business Law Journal* 338, 341.

> [I]mproving financial capability [of consumers] is complimentary to, and not a substitute for, firms treating their customers fairly – and there are some firms which still have not embedded this principle into their management culture and which now need to do so.[74]

Financial literacy is an imperfect tool for market discipline. Achieving widespread behavioural change (as ASIC has recognised in Australia) ‘will be a long process’.[75]

> [P]sychological rather than informational differences may explain much of the variation in financial capability … people’s financial behaviour may primarily depend on their intrinsic psychological attributes rather than information or skills or how they choose to deploy them.[76]

Behavioural economics research suggests that the use of peer group norms and ‘active intervention by a counsellor and/or individualised advice, rather than passive information or education’[77] are the most promising forms of incrementing financial literacy and its application. The Canadian SRO model and its adoption of fiduciary obligations provides the infrastructure to achieve such a result. The present Australian financial literacy strategies do not reflect the lessons of behavioural economics, the confluence with fiduciary doctrines, or the experience (other than tactically in web site availability) of comparative jurisdictions. Australia does not presently have the personalised tutoring infrastructure to develop financial literacies. It is also susceptible to rent seeking, without the necessary insight into what constitutes effective teachable moments: ‘[C]ontextual nuances can shape behaviour and alter choices’.[78]

Should Australia adopt a Canadian SRO model, there would be some 23 000 financial advisers with potential professional accreditation as fiduciaries to address financial literacy in Australia. These advisers would also become tutors building symbiotic client relationships with common purpose. A systemic lift in financial literacy standards of client and adviser alike should result. ASIC presently has responsibility for financial literacy implementation. It has neither the resources nor culture to perform that role effectively. ASIC is largely restricted to tactical online information provision rather than involvement at teachable moments. Implementation responsibility therefore, should be removed

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[74] Ibid.
[75] Adele Atkinson, *Evidence of Impact: An overview of financial education evaluations* (Financial Services Authority Consumer Research, 2008) 68
[76] David de Meza, Bernd Irlenbusch and Diane Reyniers, *Financial Capability: A Behavioural Economics Perspective* (Financial Services Authority Consumer Research, 2008) 68.
[77] Ibid.
[78] Polina Demina, ‘Broker-Dealers and Investment Advisers: A Behavioural Economics Analysis of Competing Suggestions for Reform’ (2014) 113 *Michigan Law Review* 429, 439 citing Michael S Barr et al, ‘The Case for Behaviourally Informed Regulation’ (2009) *New Perspectives on Regulation* 25–26.

from ASIC, and as national productivity policy, be awarded to those that can teach, preferably in the context of SRO Client Relationship Model (CRM) adoption.

2.9 Fiduciary duty as a Damoclean sword

> [F]iduciary duties are difficult to define and inherently flexible. We think that is one of their essential characteristics: they form the background to other more definite rules, allowing the courts to intervene where the interests of justice require it[79]

Creative compliance: 'the use of legal loopholes in order to allow the legitimate circumvention of criminal/civil laws and regulations'[80] becomes risky for their practitioner.

This analysis is central to resolving causes of NBFE failure in Australia. Its statutory omission aids and abets creeping corruption underscoring the trust deficit between financial intermediary and client. '[T]he term "fiduciary duty" means different things to lawyers and non-lawyers. Even lawyers use the term in different ways.'[81]

> There needs to be clarity about fiduciary responsibility, backed by a tough regulatory regime that says: if you misbehave, you are out – and for good.[82]

That is the Damoclean Sword, to be wielded by a reformed regulator.

Why is Australia reluctant to embrace statutory fiduciary obligation in the investment chain? Why, in Australia, are the economic interests of investors and beneficiaries subsumed by processes of statutory compliance? The Canadian model is 'admirably capacious'.[83] 'Nothing in the nature of fiduciary power suggests that it may be exercised only in relation to proprietary or economic interests'.[84] Conversely, from a community expectations perspective, '[f]eelings of exploitation feed naturally into fiduciary law's rhetoric of betrayal.'[85]

There is a tendency to confuse principles based regulation, including reliance on fiduciary obligations, with light touch regulation, a misnomer: 'a principles-based approach does not work with individuals

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[79] *Fiduciary Duties of Investment Advisers* (Paper No 215), above n 54.
[80] Simon Ashby, *The Turner Review on the Global Banking Crisis: A Response from the Financial Services Forum* (Nottingham University, 2009) 17.
[81] *Fiduciary Duties of investment Intermediaries* (Paper No 350), above n 25, [3.11].
[82] Lord Myners, (Third Report of the Select Committee on Business, Innovation and Skills UK, 2013–14) House of Commons 603 Evidence 19.
[83] Paul B Miller, 'A Theory of Fiduciary Liability' (2011) 56(2*) McGill Law Journal* 235 [102].
[84] Ibid.
[85] Richard Joyce, 'Fiduciary Law and Non-Economic Interests' (2002) 28 *Monash University Law Review* 237, 240.

who have no principles'.[86] This is not the case: the extension of fiduciary responsibility over prospective malfeasors, properly enforced is certainly not light touch. Community expectations of fiduciary obligation, now enshrined in Canadian statute,[87] are based on 'the reasonable expectations of one person that another would act in his [practical] interests. This entails that a beneficiary may establish a fiduciary relationship unilaterally', provided there is a reasonable basis,[88] surely a Damoclean Sword. This is where Australian law[89] and law of comparable jurisdictions may begin to converge: reflecting community expectations in the law.

2.11 Statutory or judicial intervention?

Scholarly opinion, 'particularly in the exercise of discretionary power'[90] supports broader general law fiduciary interpretation of best interest alongside its proscriptive statutory twins. Best interest requires positive actions of commission or omission, not mere process. There is no HCA judicial confirmation of this opinion. An alternate tactic, in the absence of consistent fiduciary obligation in the investment chain is to amend the *Corporations Act* and the *ACCC Act* following the thrust of the broadly drafted UK statute: directors 'must act … to promote the success of the company. …'[91] The amendments must include the economic objectives of investing and the fiduciary nature of those participating in the investment chain. Statutory reform should ensure that all NBFEs are included.[92] As in the UK, judicial interpretation and the inclusion of general law principles will still be required, so the preferable view is for both tactics. Traditional fiduciary obligation assures the investment chain, enlivens *Barnes v Addy* liability of knowing colluders, with support from statutory reform.

The objective always must be financial consumer confidence balanced with the encouragement of entrepreneurship through reform of the Business Judgment Rule (BJR). This objective could be written into an investment code, emulating the UK Stewardship Code, the German Corporate Governance Code, and the US Global Fiduciary Standard. These would be administered by the SRO architecture, with penalties imposed by an administrative arbiter, with ASIC as the ultimate enforcement agency of the SROs and the arbiter.

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[86] Iain MacNeil, 'The Trajectory of Regulatory Reform in the UK in the Wake of the Financial Crisis' (2010) 11 *European Business Organisation Review* 483, 499.
[87] In Germany and the EU, civil law duties of care are now codified in EU statutes.
[88] Miller, above n 83, [70].
[89] See, generally, Donald, 'Regulating for fiduciary qualities of conduct', above n 43, 150.
[90] Rosemary Teele Langford, 'The duty of directors to act bona fide in the interests of the company: a positive fiduciary duty? Australia and the UK compared' (2011) 11(1) *Journal of Corporate Legal Studies* 215, 233.
[91] *Companies Act* (UK) s 172 adds six categories of positive actions required to be addressed by directors.
[92] The Hayne Royal Commission may address this issue in respect of insurers.

3. RELATED PARTY TRANSACTIONS REFORM

3.1 The nature of the problem

The Australian NBFE sector has been plagued with abhorrent and egregious conduct associated with related party transactions (RPTs) and consequential conflicts of economic interest. The conduct may not strictly amount to legal malfeasance. Statutes and contracts are focussed on legal rights and interests rather than investor value outcomes. The correlation analysis of 199 senior court judgments demonstrates Australian propensity for related party transactions and their consequences.[93] Notably, other professions are limited in respect of related party conduct. It is one of the factors preventing Australia from having a properly professional financial services sector.

'[R]elated party transactions are inherently problematic under any circumstances'[94]. They 'undermin[e] … fiduciary responsibility…[95] RPTs 'divert value from a corporation'.[96] Their cousin, tunnelling, is the 'transfer of resources out of a company [or other entity] to its controlling shareholder … [by] dominant shareholders and managers'.[97] *Prime Trust*[98] illustrates how value shifting by related parties can lawfully occur in Australia. Such deficiencies in the law strike directly at the veracity of Australia's investment landscape.

Some argue that RPTs are in the best interest of the company but this laxity in regulation leads directly to creeping corruption and systemic failure.[99] Shareholder approval for a specific transaction easily leads to transfer of value and loss of control since only specific transactional approval is required, not its long term value impact approval. RPTs are regulated using a number of legal tools, of varying efficacy and depend on the efficiency of enforcement. Prohibition of some transactions, including related party loans and loan guarantees used to gain control of it would be effective in some Australian

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[93] See above ch 3, tab 3.25. Where related parties were involved, 93.42% of those same cases involved deceptive, misleading or unconscionable conduct; 95.31% involved dishonesty, and 100% involved breaches of directors' duty. See also Australian Government Productivity Commission, *Competition in the Australian Financial System* (Draft Report, January 2018) ch 7 'Dominance through integration', fig 7.1; ch 11 'General insurance providers', fig 11.3. See also Kevin Yi Liu, *Australian Superannuation: Operational Structure, Investment Performance and Trustee Governance* (PhD Thesis, The University of Sydney, 2013) 166–176.

[94] Duncan C Jessup, John H Farrar and Susan Watson, 'Related Party Transactions in New Zealand: An Empirical Study of a Flawed System' (2012) 30(2) *Companies & Securities Law Journal* 110, 113.

[95] Ibid.

[96] Luca Enriques, 'Related Party Transactions: Policy Options and Real-World Challenges (with a Critique of the European Commission Proposal)' (2015) 16 *European Business Organisation Law Review* 1, 2.

[97] Ibid 3.

[98] *Lewski v ASIC (No 2)* [2017] FCAFC 171 [190] (Greenwood, Middleton, and Foster JJ).

[99] In New Zealand it led to the complete collapse of its finance company sector: 'almost 40% of all RPT's are with executives…'. 'The result is that New Zealand has been a relatively safe haven for Australian fraudsters' quoted in Jessup, Farrar and Watson, above n 94, 136–38.

creeping corruption cases, but may not be in the best interest of the company when the related party is the only willing participant. Selective prohibitions may be more pragmatic than a total prohibition.

3.2 Comparative insights

The *untreue*[100] principle, now codified in EU law and supported by the German Corporate Governance Code as general law governs intent. German directors are required to observe the spirit and intent of the law, not only its statutory manifestations. EU regulation of related party transactions recognises they may have potential value, has not pursued the prohibition philosophy, provides for business judgment but is balanced by codified civil law counterweights. This architecture reflects fiduciary stewardship concepts. This is not so in Australia unless there is a broadened fiduciary relationship where, as in the UK,

> It [creative compliance] is essentially the practice of using the letter of the law to defeat its spirit, and to do so with impunity.[101]

The UK has, by widening director statutory responsibility to company long term success, introduced subjectivity. Disclosure, including the nature of the related party interest not just its existence, and prior fully informed consent of the disinterested members of the company form the basis of modern UK related party transaction governance.[102]

Canadian regulation of financial advice requires consideration of whether a conflict may be 'expect[ed] to arise between the firm including each individual acting on behalf of the firm and its client'.[103] Disclosure of itself is not sufficient. There must be a proactive business system of identifying conflicts of interest with prospective clients by the firm and participants in it, 'consistent with the best interests of the client',[104]

3.3 Excision: prohibition not prioritisation

RPTs and tunnelling are so deep seated and problematic in Australian NBFEs that cultural change requires at least selective prohibition, not prioritisation. This excision should be for a period of at least five years, or until governance practices demonstrably meet community expectations of trust and loyalty. ASIC needs RPT ex ante review and prevention powers, directly addressing the causes

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[100] Enriques, above n 96, 24.
[101] Ashby, above n 80, 17.
[102] *Companies Act 2006* (United Kingdom) s 200.
[103] *National Instrument 31-103CP* (Canada) pt 13.4.
[104] *Approved Person responsibility to address conflicts of interest* (Investment Industry Regulatory Organisation of Canada) Rule 42.2.

of systemic failure identified in the correlation analysis. The evolution of Australian superannuation law provides guidance although it still allows prioritisation. In the superannuation sector, '71% of retail funds … employ related-party service providers, compared with 52% of not-for-profit funds', with differing patterns of ownership and control.[105] 'Extremely high levels of concentration are …exhibited in a number of outsourcing markets',[106] most particularly asset allocation consulting, audit, actuarial and custody. APRA's ex ante supervisory posture and small number of supervised entities is a different proposition to the difficulties presently facing ASIC. ASIC will need data. This will be provided by each NBFE having a proactive system of identifying and disclosing potential conflicts of interest and lodgement of relevant offer documents and supporting contracts. Whilst not the same as notarisation and commercial court lodgement powers in German law, it could emulate process extending contractual veracity to external independent review.

Failure to disclose will result in loss of BJR protection under *Corporations Act* s 180(2)(b). It is a more stringent test than the present conflicts register which only requires disclosure of actual conflicts of interest. If these are reviewed at all, it is normally ex post. Different conflict of interest standards presently arise in NBFEs because of the fragmented statutory architecture: excision through prohibition will provide a period through which policy and statutory harmonisation can occur.

For some vertically integrated NBFEs, this policy will be problematic, requiring divestment of controlled entities but an opportunity for directors to focus on their core business.

[105] Kevin Yi Liu, *Australian Superannuation: Operational Structure, Investment Performance and Trustee Governance* (PhD Thesis, The University of Sydney, 2013) 147.
[106] Ibid 167–8.

4. REDESIGN OF THE ARCHITECTURE — FINANCIAL ADVICE AND WEALTH MANAGEMENT AS A PROFESSION

4.1 Australian confusion

Implementation of fiduciary principles and the elimination of conflicts of interest requires a national architecture which subscribes to those objectives. The financial planning sector should be divided into professional advice providers separately from product sellers,[107] similar to the distinction between investment advisers and broker dealers in the US.

Financial planners and wealth managers in Australia are not professionals in the accepted sense of that term. The *FoFA*[108] reforms have not achieved that desirable evolution to status-based fiduciaries. Clients are in a lesser legal position than before those reforms. *FoFA* subsumes general law fiduciary duty behind compliance with statutory process, safe harbour defence for compliance with that process,[109] has differing liability for employees of financial planning firms and their authorised representatives and does not extend procedural protections to non-retail investors (who may only have retail level skills). Political influence is the cause: it is a sop, without remedy, removing general law protection of undivided loyalty of financial and corporate advisers to their retail clients. It further entrenches the doctrine of prioritisation over prohibition. It ignores the essential contribution of financial products and services provision to daily life. It is industry centric, not consumer centric.

4.2 Comparative insights

Singapore does not apply statutory fiduciary duty to financial advice, but compared with Australia, Singapore does have other and greater statutory investor protections. For retail financial advice protections are underpinned by personal statutory responsibility which echoes German civil law fiduciary-like duty of care doctrines. These cannot be delegated. Similarly its intermediaries in the investment chain have statutory personal liability extending to the client, proximal or not. Singapore extends consumer protection law to retail financial advice.

In Germany, the codified and contractual fiduciary relationships between adviser and client means that the client does not consume the information, but consumes confidence in their adviser. As in

[107] Kevin Lindgren, 'Fiduciary duty and the Ripoll Report' (2010) 28 *Company and Securities Law Journal* 435.
[108] *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth).
[109] *Corporations Act 2001* (Cth) s 961B(2).

Singapore, personal liability extends to the content of marketing materials which may be separate from the disclosure document.

Germany and Singapore, in their own ways illustrate the unresolved tension in Australia between Coopers' libertarian paternalism espoused in the superannuation context, and the Wallis inspired principles of disclosure, advice and financial literacy. In Australia there has not yet been evolution of the law (other than consumer credit and industry superannuation default funds) to reflect investors as consumers rather than capital providers.

Neither does the UK does not impose a statutory best interest duty on financial advisers. The direction of regulatory policy is to embed 'legal duties in an industry structure which provides the expertise and resources for good governance,'[110] similar to the Canadian SRO model. It rests on fiduciary concepts without actually codifying them.

4.3 Applying the Canadian model in Australia

Whilst Canada and Australia share jurisprudence provenance, their fiduciary traditions differ. If the objective of further Australian reform is to transform its financial planning and wealth management sectors into a respected profession, this will require reform of how regulation is implemented and reform of Australia's restrictive fiduciary tradition. The distinctive Canadian regulatory system based on fiduciary duty and responsive regulation has much to offer Australia in this quest for reform of its financial advisory sector. It evolves the regulation of financial services advice into an ex ante posture delivered and policed by the financial planning industry organisations themselves. They would have regulatory responsibility supervised, audited and enforced by ASIC.

They will also have financial literacy objectives. They will replace government agencies including ASIC in financial literacy education. These are mostly tactical and antiseptic, ignore behavioural economics research which requires active interventions in teachable moments alongside the provision of proper, useful and comprehensible disclosure during active investing. One objective is to generate deeper client relationships akin to the traditional German private banking model and Canadian CRM both disciplined by fiduciary responsibility and improved client financial literacy. Proximity to the client engenders knowledge transfer and the re-establishment of trust. The fiduciary obligation is

[110] Laura Paglia, *Standard of Conduct for Advisors and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty when Advice is provided to Retail Clients* (Canadian Securities Administrators Consultation Paper 33-403, 2013) 20–22 citing *Fiduciary Duties of Investment Advisers* (Paper No 215), above n 54.

underpinned by personal liability of directors and senior management extending to the approval of financial products sales to clients. Proximity renders the need for safe harbour defence obsolete.

Robo-advice is likely to become more widespread and problematic: the temptation of ‘dark pools’ of capital irresistible. There will be no teachable moments requiring extension of of consumer law following NCCP and MySuper principles. The Australian equivalent of the CRM will need to account for the rapid march of technology. ASIC asserts a technology neutral regulatory environment.[111] Some scholars assert that ‘financial consumers are *more* willing to trust the digital platform than a face-to-face adviser,[112] noting that ‘willingness … to trust the robo adviser comes close to Finn’s “fiduciary expectations’ thesis’.[113]

General law fiduciary duties and their prescriptive extension are to reflect what best interest actually means. Inter- and intra-statutory definitions need harmonisation and simplified codification in a comprehensible standard. The Global Uniform Fiduciary Standard and some of the jurisdictional codes provide guidance. In Canada, best interest standards automatically include fiduciary and non-fiduciary duties from all sources of law in a CRM enforced through SROs. This eliminates present ambiguity in Australian best interest interpretations. Duties would extend to the SRO, its directors, officers, professional advisers, and their financial planners.[114] As in Canada, Australia would have a principles-based interpretation of the nature and scope of fiduciary obligations in financial advice which meet implicit community assumptions. It results in a uniform fiduciary standard previously proposed in the US,[115] including fair dealing principles. In Australia, SRO models (eg in general insurance) have not met their customer expectations. It is not the SRO model that is faulty: it is the implementation of it by those willing to corrupt its objectives and engage in egregious behaviour. SRO models require the support of fiduciary law and effective enforcement by the regulator.

The necessary national infrastructure presently exists in Australia. There are 24 323 registered financial planners, a number likely to diminish.[116] The Australian SRO model would apply inter alia to the Financial Services Council (FSC), Association of Independent Financial Planners (AIOPP),

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[111] *Providing digital financial advice to retail clients* (ASIC Regulatory Guide 255, August 2016) [RG255.6].
[112] Simone Degeling and Jessica Hudson, ‘Financial Robots as Instruments of Fiduciary Loyalty’ (2018) 40 *Sydney Law Review* 63, 78.
[113] Ibid citing Paul Finn, ‘Fiduciary Reflections’ (2014) 88(2) *Australian Law Journal* 127, 139.
[114] Directly employed and Authorised Representatives
[115] Demina, above n 78.
[116] Alice Uribe, ‘Financial Adviser exodus puts $900b of savings in flux’, The Australian Financial Review (Sydney), 23 May 2018, citing <<https://www.adviserratings.com.au/media/50046/ar_2018_landscape_report_summary.pdf>.

Financial Planning Association (FPA), Association of Financial Advisers (AFA), and the Independent Financial Advisers Association of Australia (IFAA). These organisations will require reform of their objectives, governance, culture, and operations to implement the model. They would become regulators generating 'significant compliance and cooperation',[117] not industry lobbyists. There has been limited acknowledgement of a self-regulation model with the establishment of the Financial Adviser Standard and Ethics Authority (implementation commencing in 2020). Two strategic benefits arise: these are the removal from ASIC of the impossible burden of policing ex post, every financial advice transaction, and transitioning the financial planning sector into a self-regulated ex ante supervised profession with fiduciary status. Enforcement of Australian SROs would be ASIC's role, similar to Canadian Securities Administrators.

These reforms would solve the systemic problems in the financial advice sector in Australia which incremental Australian statutory reforms to date, including FoFA[118] do not. Implementation must be statutorily supported: eliminate non-reliance clauses in advisory contracts which remove fiduciary liability; extend client fiduciary obligations to the directors and senior management (which cannot be delegated) of financial advisory and wealth management firms; and apply retail consumer protection law to the sale of all financial products and services. As in Canada, remove statutory safe harbour defence in retail financial advice.

4.4 Licencing issues: entity and adviser

Australian Financial Services Licences (AFSLs) operate as a franchise facilitating treaty shopping by advisers amongst corporate AFS licensees. Evolution of financial planning to professional status will require the licencing of financial planners personally based on personal educational and performance competencies. Competence already requires future tertiary examination, but should also require relevant work experience, professional year, and annual accreditations based on continuous professional development. Personal licensing facilitates transferability of skills sets and places responsibility directly with the individual fiduciary (as in medicine). This reform harmonises Australia with comparable jurisdictions. The SROs will be required to maintain lists of their accredited and licensed advisers and advise ASIC. It will maintain a national database as regulator of the SROs. The integrity of this register will be enhanced by lodgement of movements of advisers and reasons for termination if any.

[117] Paglia, above n 110, 27.
[118] *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth); *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth).

Corporate AFSLs will continue since they provide financial services and sell financial products. As with other professions that are corporatised, personal licensing need not damage the economic value of their employer entity. AFSLs should not be a tradeable commodity. Ownership change should require ASIC approval, only to be granted as if it were a new AFSL. RSE and Banking licensing are examples.

4.5 Redefine retail, sophisticated and professional investors

Present definitions are arbitrary and serve to remove protections when they are needed and to eliminate or reduce investment opportunities for some able to discern the truth in disclosure and advice. The extension and primacy of fiduciary obligation serves to reduce or eliminate the need for arbitrary statutory typology of investor. In *Wingecarribee*[119] and *Bathurst,*[120]directors and officers of local authorities, removed from the protections afforded to retail investors, nonetheless had the financial literacy of retail investors in respect of the complex financial products sold to them in their roles in their employing organisation.

The implementation of the proposed reforms eliminates the need for arbitrary definitions. They also eliminate the pressure for 'libertarian paternalism'. They eliminate the systemic deficiencies and provide the basis upon which a market conduct system can properly work.

[119] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq*) [2012] FCA 1028 (Rares J).
[120] *ABN Amro Bank NV v Bathurst Regional Council* [2014] FCAFC 65 (Jacobson, Gilmour and Gordon JJ).

5. MARKET CONDUCT REGULATION FOR THE 21ST CENTURY — REFORM OF THE ROLE AND OPERATIONS OF ASIC

5.1 The nature of the problem

Regulatory and supervisory agencies are an essential component of the national architecture. They too, must share the reform objective. Indeed, it is in their interest to do so: reform is the only means by which they can ameliorate and eliminate the excoriating criticisms they face.

ASIC is mandated as an ex-post market conduct regulator with broad responsibilities.

> [E]x post strategies are often dysfunctional in the light of behavioural economics … [which] reveal that the traditionally highly legislated monitoring and control strategies need to be evaluated in a different light … to avoid mindless decision making…[121]

As Australian judicial frustration and scholarly opinion illustrates, present policy has led to the Age of Statutes:[122] a large increase in the volume and number of relevant statutes, with often conflicting and confusing definitions of important basic terms including financial services and best interest.

ASIC is subject to considerable public and private criticism. It is a prisoner of the *ASIC Act* and the *Corporations Act*. It does not meet its stakeholder expectations. Reform is needed to ameliorate these expectations gaps. Strategic reform of ASIC is imperative. ASIC requires reform of its charter, mandate, governance, culture, employment arrangements and posture. It should lead, not follow, by setting out a proposed reform agenda having considered the research available to it. A redefined charter requires amendment of the *ASIC Act*.[123] A redefined mandate leads directly to analysis of ASIC's human and financial resources required for implementation. As with the Federal Financial Services Authority (Germany) (BaFin), a culture of natural politeness (in administrative compliance) and stakeholder respect (including in enforcement) is a component of the spirit of the law. Governance reform to a two tier board structure consistent with Uhrig[124] with fulltime non-executive and executive roles should be implemented. As in the German governance system,[125] stakeholder representation should be balanced with management competencies. Governance reform has since

[121] Hoeppner and Kirchner, above n 11, 251.
[122] Leeming, above n 41.
[123] *Australian Securities and Investments Commission Act 2001* (Cth) s 1(2).
[124] John Uhrig, *Review of the Corporate Governance of Statutory Authorities and Office Holders* (Report, Commonwealth of Australia, Canberra, 2003) ['Uhrig' or 'Uhrig Review'].
[125] See below s 8.

been rejected by ASIC. Its mandate and its reactive, issue based posture is 'not fully replicated by any other conduct regulator globally'.[126] Or in Australia.

5.2 Insights from comparative jurisdictions

Balancing industry development with compliance cultures requires pragmatism. This pragmatism should extend to clarity, certainty, and consistency in public policy, law, and regulation both prescriptive and principles based. Singapore's objective is to reduce 'productivity sapping ambiguities'.[127] Pragmatism, within a unified system of law, is an objective of German financial regulation. A combination of principles-based regulation observing the spirit as well as the letter of the law founded on natural politeness, consultation, civil law duty of care and fiduciary doctrines, and proximity to supervised entities gives predictability to stakeholders. Canada, similarly, has embarked on a regulatory journey cognisant of behavioural economics research and given legislative form as Responsive Regulation with implementation through its SROs. Australia's box-ticking compliance culture could be made obsolete by emulation of these insights.

Conversely, the UK as in Australia, community anger at misplaced expectations generates public demand for revenge for subversion of economic interests behind statutory compliance. Public demand results in political pressure for prescriptive supervision by the same regulators that have been part of the problem. There is some recognition in the UK that regulators cannot police every commercial transaction or dictate corporate culture. That is not recognised in Australia where ASIC is expected to do both at ever increasing cost, an impossible burden. That compliance with process has not led to expected investor outcomes will be a cultural challenge for it and proponents of statutory accretion.

5.3 Ex ante or ex post regulation?

Reform should apply models from Canada, Germany, and Singapore using existing professional and industry associations as bottom up quasi-regulators, educative and consultative: the SRO model. This eliminates inexhaustible demands for market conduct services from the central regulator.[128] Ipso facto, ASIC regulation becomes ex ante and supervisory rather than ex post and reactive. Behavioural economics scholarly research supports this change in posture, regarding ex post strategies as 'behaviourally dysfunctional … [requiring a] counterintuitive shift of rule-making competencies:

[126] Chester, Gray and Galbally, above n 69, 34.
[127] Andrew Campbell, 'Insolvent Banks and the Financial Sector Safety net – Lessons from the Northern Rock Crisis' (2008) 20 *Singapore Academy of Law Journal* 316, 337.
[128] Kingsford Smith, above n 8, 702.

from public to private ordering.'[129] In effect, Responsive Regulation. Discipline in implementation will be strict: underpinned by fiduciary obligation in the investment chain enforced by an effective properly mandated ASIC.

5.4 The contingent risk of regulatory interventions

The timing of regulatory action on a NBFE can have significant and detrimental impacts on the credibility of that entity, its directors, and its investors. This includes the value of underlying assets, the return on investments, their liquidity, and member balances. Unintended consequences of regulatory action can easily result in loss of investor confidence (present and prospective), and compromise of underlying assets values.[130] Reform of ASIC's mandate to induce proximity reduces this risk. As does a holistic lift in standards.

5.5 Educational standards, competencies, and culture in regulatory agencies

Each of ASIC, APRA, and the FWC will require cultural and educational reform. This extends to powers being exercised in commercially relevant timescales. Cross-fertilisation of market conduct and supervision cultures within ASIC and APRA broadens the available tools. Whilst 'the role of a publicly funded regulator is to deter unlawful behaviour … it [ASIC] is tasked to regulate for the benefit of society as a whole'.[131] This necessarily means lifting standards of behaviour and competence of market participants.[132] Empirical analysis suggests this objective has not been reached. Effective regulators must have a stakeholder and societal teaching role including in the training of directors and trustees: it is a component of supervision, lifts standards and competencies of lay people appointed to boards. ASIC staff need skills sets to take personal responsibility for timely and useful relationships with client stakeholders who now provide ASIC's funding. ASIC needs to build its own CRM.

Surveillance, compliance and enforcement are important but not the only tools in market integrity. The human resources skills base in ASIC and APRA should be broadened to include senior staff with industry, capital markets, and microeconomics experiences. Remuneration and employment contracts require independent review to achieve effective recruitment, performance and allocation of financial

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[129] Hoeppner and Kirchner, above n 11.
[130] Australian Government The Treasury, *Review of the Trio Capital Fraud and Assessment of the Regulatory Framework* (Report, 2013) 14.
[131] Michelle Welsh and Vince Morabito, 'Public v Private Enforcement of securities laws: An Australian empirical study' (2014) 14(1) *Journal of Corporate Law Studies* 39, 46, 78.
[132] *Australian Securities and Investments Commission Act 2001* (Cth) s 1(2).

resources. This may require more independence from government, including relief from the *Public Service Act* and prosecution agencies.

6. DISCLOSURE REFORM

6.1 Disclosure is an international problem

Market based regulatory systems rely heavily on disclosure, including disclosure of conflicts of interest. 'Such disclosure is worse than useless if it is not comprehensive'.[133]

> The belief that the best approach to information asymmetry is the provision of additional data … [is] acceptable if accompanied by full, even if largely incomprehensible, disclosure,[134]

leads to documentation complexities under the acceptable guise of transparency which hide the narrative required to make sound investment decisions.

Disclosure documents often follow legal form rather than economic substance focussed on the sustainability of business models. This has been a particular problem in non-prudentially regulated MIS in Australia and the UK which do not have US style Management Discussion & Analysis (MD&A) sections in their offer documents. These must be in plain English.

'Does suitable documentation exist at all'?[135] Disclosure has become an end in itself, reflecting regulation of market behaviour through process rather than the primacy of the investor or beneficiary reliant upon trusted financial intermediaries. Regulation is seen 'through the eyes of the industry rather than its customers'[136] with penalties for 'market abuse rather than customer abuse'.[137] Disclosure is at best an imperfect tool in a financial consumer market where conflicts of interest are permitted. What financial consumers need is trust generated by long term 'deeper'[138] relationships. This is the European fiduciary-like duty of care tradition, albeit subverted (as in the UK) in recent decades by the advent of product selling and transactional relationships.

6.2 Insights from comparative jurisdictions

In Germany, retail investors are treated as financial consumers rather than capital providers. This policy widens disclosure obligations to investors enlivening its *culpa in contrahendo* doctrine with

[133] John Kay, *The Kay Review of UK Equity Markets and Long Term Decisions Making* (Final Report Department of Business, Innovation and Skills UK, July 2012) 67 ['Kay' or 'Kay Review'].
[134] Ibid 35.
[135] Christopher Chen Chao-Hung, 'Product due diligence and the suitability of minibonds: taking the benefit of hindsight' [2011] *Singapore Journal of Legal Studies* 309, 322.
[136] Kay, above n 133, 47.
[137] Ibid.
[138] Ibid 46.

statutory 'very detailed level of codification'.[139] Disclosure must be in a 'comprehensible form'.[140] It is not information that is being consumed, but confidence in the person providing the disclosures.[141] Law reform designed to unlock retail investor savings, relying on their financial literacy (but without formal investor education) and on advice, also required liberalisation of financial products 'easily understood by the "average retail investor"'…[142] German law differs substantively from Australian law in these respects.

Australia is not unique in suffering from systemic creeping corruption arising from disclosure limitations. In Australia, how is complete disclosure of economic rather than transactional interest to be enforced where there is no legal obligation to do so? Where there is no interest in it by the parties concerned? 'It is necessary to shift legislator's attention from ex post enforcement to ex ante supervised self-regulatory regime'.[143] Proactive disclosure (including potential conflicts of interest) should apply to all in the investment chain.

6.3 Information asymmetry: is a governance regime based on disclosure sufficient investor protection?

Multilayered MIS structures can be complex for all but the most sophisticated and attentive retail investor to understand.[144] It is 'not uncommon that a MIS invests in another MIS to gain exposure to underlying assets in a cost effective manner (eg a retail feeder fund investing in wholesale funds that have greater economies of scale. It is therefore not unsuitable for retail investors'.[145] Lack of product understanding also extends to financial advisers, wealth managers, directors of MIS and trustees of APRA regulated superannuation entities and self-managed superannuation fund trustees. In the US, lack of financial product knowledge by the fund manager has required regulatory intervention.

Mandatory disclosure of portfolio assets held directly or indirectly in other investment entities by REs and Registrable Superannuation Entities (RSEs) would identify illiquid assets, increase investor scrutiny of investment manager behaviours, and provide a more efficient market. One of the problems

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[139] Sebastian Barry and Hannes Bracht, 'The Implementation of the MiFID into the WpHG' (2008) 9(9) *German Law Journal* 1177, 1185.
[140] Niamh Moloney, 'Building a Retail Investment Culture through Law: The 2004 Markets in Financial Instruments Directive' (2005) 6 *European Business Organisation Law Review* 341, 386.
[141] Susanne Kalss, 'Civil Law Protection of Investors in Austria – A Situation Report from Amidst a Wave of Investor Law Suits' (2012) 13 *European Business Organisation Law Review* 211, 225
[142] Moloney, 'Building a Retail Investment Culture through Law', above n 140, 352.
[143] Dirk Zetzsche, 'Hidden Ownership in Europe: BAFin's Decision in Schaeffler v Continental' (2009) 10 *European Business Organisation Review* 115, 146.
[144] Senate, PJC, Parliament of Australia, *Inquiry into the collapse of Trio Capital* (2012) 31.
[145] Ibid.

in disclosure is how to report underlying assets in multilayered structures, especially in foreign jurisdictions, where a custodian holds the assets and where there is constant asset turnover. The *ASIC Act* and the *Corporations Act* previously imposed restrictions on the investment strategy of registered MIS. These restrictions were removed to allow diversification provided that the investments were not made for the purposes of avoiding regulation. The removal of this restriction facilitated fraudulent behaviour in two Trio MIS in 2009.[146]

6.4 Tactical statutory reforms to rectify systemic deficiencies in disclosure

Problems in Australian disclosure can be addressed by the adoption of international standards. Examples include Undertakings for Collective Investments in Transferable Securities (UCITS) being 'a highly regulated, supervised, and transparent savings vehicle',[147] and which are used in non-EU jurisdictions (not Australia) for retail investment. Singapore's implementation of a Code of Best Practice on Collective Investment Schemes aligns Singaporean Collective Investment Schemes with international developments in funds management (including UCITS compliance), the Markets in Financial Instruments Directive (MiFID) 11/ Markets in Financial Instruments Regulation (EU) from January 2018),[148] and the International Organisation of Securities Commissions (IOSCO). '[R]egulators in Europe are practically falling over themselves to demonstrate their commitment to protecting the humble retail investor'.[149] MiFID is supported by injunctive and compensatory remedies. These are all recognitions of the limits of disclosure alone as an efficient markets disciplinary mechanism.

Australia does not participate in these international standards despite pretensions of becoming a world financial centre. For simplicity in reform of unregistered MIS, emulating MySuper default funds provides one in-country starting point. Emulation of Singapore's *Business Trust Act* for actively managed MIS provides another. An Australian financial product with these characteristics could be compliant with UCITS and other international standards.

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146 Ibid Committee Hansard (6 September 2011), xxiv, 75 (Greg Medcraft).
147 Moloney, 'Building a Retail Investment Culture through Law', above n 140, 352.
148 John Armour, Martin Bengtzen and Luca Enriques, *Investor Choice in Global Securities Markets* (New Special Study of the Securities Markets Columbia Law School/Columbia Business School Program on the Law and Economics of Capital Markets, March 2017) [7.1].
149 Niamh Moloney, 'The Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?' (2012) 13 *European Business Organisation Law Review* 169, 171. See also P Davis, 'Protecting Investors Proves Tricky' (2011) *Financial Times Funds Management Supplement* 21, 11.

With limited exceptions,[150] Australian NBFE investors are still not treated as financial consumers. Fair dealing principles found in other jurisdictions are subsumed by statutory compliance. Compliance and enforcement standards do not change the values and ethics of organisations. They merely encourage box ticking by those with executive responsibility for disclosure. This will increase as financial advice and products become algorithmic and robotic.

Other problems need to be resolved by tactical reform of the *ASIC Act* and *Corporations Act*, and evolution of ASIC's mandate. These reforms should include: ASIC having ex ante powers to intervene in financial products disclosure (including material contracts and intermediation contracts); eliminate the offering of unsound business models by the introduction of business planning (similar to US MD&A) in disclosure documents setting out the comprehensive business case certified by the directors; disclosure of economic not just transactional interest; prohibit financial products issuance where sales of MIS units to new investors are required to fund operational costs of MIS properly attributable to earlier investors (the Ponzi MIS); where business models are leveraged, detailed disclosure of economic and legal risks and an integrated analysis of the impacts of multiple leverage on the investor with attendant disclosure of any related party interests; for retail investors, apply the *National Consumer Credit Protection Act* to MIS and other financial products; related party lending limited to non-recourse financing only; and reducing the burden of proof on investor litigants, requiring only that a disclosure statement was inaccurate at the time that statement was made.

6.5 Primacy of investment objective in disclosure documents

Murray identified lack of investment objective in the *SIS Act*, despite the sole purpose test. This defect in the law afflicts other NBFEs, including MIS. Value outcomes and economic optimisation for investors and beneficiaries, together with capital preservation, all pillars of trust law, are not legal rights in the *Corporations Act* or general law unless stated to be so in the governing disclosure documents or advisory contracts (retail and corporate). For MIS, this is the constitution, usually deficient in this key plank of investor protection. Statutory intervention enforcing disclosure of this missing link is entirely consistent with fiduciary principles, equitable concepts of stewardship and German civil law duty of care.

This reform moves the offer document beyond description of legal rights, often complex if comprehensible at all to the financial consumer, being a positive duty to aid financial literacy through more meaningful disclosure.

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[150] *National Consumer Credit Protection Act 2009* (Cth); *Consumer and Competition Act 2010* (Cth).

6.6 Reform of whistleblower regulation

Whistleblowing can be a dangerous sport in Australia, but together with empowered investors, a key market disciplinary method. There is little encouragement to be had either from institutional employers or regulators which may not act on or even read, the information with which they have been provided. Whistleblowing can impart the sunlight of disclosure. The spirit has been clouded by intimidation and bullying in banks, registered organisations and NBFEs regulated by the *Corporations Act*. Proposed reform[151] needs to include: positive obligations placed upon ASIC, APRA, and the ROC to investigate disclosure within a specified period; harmonise each of the *Corporations Act*, *SIS Act*, and *Fair Work (Registered Organisations) Amendment Act* with the *Public Interest Disclosure Act* for the provision and receipt of disclosures. Whistleblowers, emulating US judicial interpretation, should report directly to their relevant regulator, not their employer.

[151] Treasury Laws Amendment (Whistleblower) Bill 2017 (Cth).

7. AUSTRALIA AS A WORLD FINANCIAL CENTRE

There has been considerable discussion and government policy directed at Australia becoming at least a regional financial centre,[152] originally dating to Campbell in 1981 and Wallis in 1997. Australia has not emulated the prominence of other regional centres in Singapore and Hong Kong. Partly, this is because of deficiencies in regulation and law. The Australian system is compromised, limiting the benefits of a market conduct posture through deficient legal implementation. The story of modern Australia is incomplete, incurring large direct costs to present investors and opportunity costs to their progeny.

Modern German law recognises that regulation can have a negative burden on an entrepreneurial economy. In practice the intertwined EU and national jurisdiction mix of self-regulation, co-regulation, (so-called soft law) and government regulation, disciplined by the primacy of fiduciary or fiduciary-like principles supports entrepreneurship. The UK, in an earlier context but relevant to its Brexit negotiations has a 'clear interest in ensuring that those markets remain centred in London.'[153] '[I]t cannot readily support forms of regulation that threaten its competitive position'.[154] Singapore's regulatory architecture is integrated with national economic objectives. Conversely, Australia cannot remain an international outlier: its regulatory architecture needs to reflect and build upon global norms.

7.1 A Matter of National Productivity

Trio exposed deficiencies in corporate governance, law and supervision which enabled international fraud on Australian superannuation savings using related party offshore hedge funds. There is an inevitable nexus between the world's fourth largest pool of superannuation savings and its vulnerability to malfeasance.

The interface between Australia's industrial system and its superannuation savings system is a matter of considerable national significance, likely to have major economic implications for its future development and prosperity. As Murray and Heydon identify, this interface is largely unexplored territory which may expose Australian superannuation to substantial contingent risk. It directly influences and determines corporate governance practices and outcomes. These are inconsistent and

[152] See, eg, Mark Johnson, *Australia as a Regional Financial Centre* (Financial Centre Forum Report, January 2010) ['Johnson']; Mark Johnson, *Australia as a Financial Centre Seven Years on* (Financial Services Council Report, June 2016).
[153] MacNeil, above n 86, 513.
[154] Ibid 504.

sometimes conflicted. Egregious behaviour is both contagious and widespread across NBFEs. The empirical data, if it has predictive veracity suggests that history will repeat itself without reform.

7.2 Australian propensity for misfeasance, malfeasance and non-feasance

'The financial services industry is particularly vulnerable to the risk of international fraud'.[155] The Australian Crime Commission noted that 'Serious and Organised Investment Fraud is not an opportunistic crime, but a calculated, sophisticated, organised criminal event that can attract experienced investors…'[156] Task Force Galilee was established in 2011 as a multi-agency response to these crime threats.

Closer to home, whilst serious, international frauds have been comparatively small and rare by comparison with investor losses arising from internal systemic failures quantified in the empirical analysis.

7.3 Strategic law reform for a globalised world

Reform is essential to reduce Australian propensity for malfeasance by quality assuring the investment chain underpinned by enforcement of fiduciary obligations. This assists harmonisation with the more insightful jurisdictions. The law matters: Australian productivity is diminished by present law. Harmonisation is required with international standards and within its own legislation. Presently, there is no consistency of economic purpose or method. There needs to be clarity, consistency, certainty, and predictability in legislation and regulation. These are all missing. Best interest duties are an example.

To start: define the economic objectives and purpose of the various components of the NBFE investment chain and give them statutory force in each of the *SIS Act*, *Corporations Act*, and *Fair Work (Registered Organisations) Amendment Act*. Similarly, harmonise director and trustee duties, categorise and define fiduciary status in these statutes. Harmonise corporate governance principles with the Australian Securities Exchange (ASX) Listing Rules[157] and enforce a Code of Governance for all fiduciaries, emulating the Global Fiduciary Standard.

To reduce Australia's outlier status, harmonise Australian law applying to financial products and financial services in similar jurisdictions, including adherence to IOSCO, MiFID, and Global

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[155] Submission to Senate, PJC, Parliament of Australia, *Inquiry into the collapse of Trio Capital* (2012), Australian Custodian Services Association 43 3.
[156] Australian Crime Commission, *Serious and Organised Investment Fraud in Australia* (2012) 1.
[157] Many NBFEs are influential in the governance of ASX listed companies.

Fiduciary Standards of Excellence principles. Australian financial product disclosure documents should adhere to UCITS principles to enable the sale of Australian financial products in other jurisdictions. There has been some progress with 'passporting' but this remains far from complete.[158] Conversely, Australia should permit the domestic sale of international UCITS compliant financial products to stimulate competition.

7.4 Aligning community expectations

There is limited community understanding of a market oriented regulatory system, its benefits, importance in Australia's future and the proper roles of the various market participants. It requires an un-politicised long term public education campaign. It should be designed to match community expectations with desired market conduct. Its mirror is a national sustained education campaign for investors and superannuation beneficiaries designed to develop a more sophisticated body of financial consumers. Implementation of the SRO system provides implementation architecture, its effectiveness to be underpinned by fiduciary obligation enforced by effective enforcement. Following the Hayne Royal Commission, the Parliamentary Committee should review quality assurance of the investment chain cognisant of models in comparative jurisdictions. This review provides the legislative basis for the subsequent education campaign.

7.5 Quality assurance of the investment chain

Fiduciary law can provide the basis upon which the investment chain is quality assured. It requires statutory support, defining the role and objectives of investment, cultural objectives, self-adoption of codes of conduct, and tactical statutory interventions. Statutory support includes licensing of all participants in the investment chain, their capital adequacy, prudential supervision; limitations on financial products leverage and much improved standard of disclosure.

[158] Originally proposed by Johnson in 2009, legislation for Asian Region Funds Passport (ARFP) and Corporate Collective Investment Vehicles (CCIV) incorporates new chapters 8A and 8B in the *Corporations Act 2001 (Cth)*. *Corporations Amendment (Asian Region Funds Passport) Act 2018* (Cth) received Royal Assent on 29th June 2019. Treasury Laws Amendment (Corporate Collective Investment Vehicle) Bill 2018 remains in the legislature. These allow for multi-jurisdictional financial product distribution (New Zealand, Hong Kong, South Korea, Thailand, Singapore, Philippines, Japan and Australia have participated in consultations). The Passport is based on mutual recognition principles. Related party transactions are regulated in the home country. UCITS principles are accorded worlds' best practice for custody. The legislation provides for the SLE model in both corporate and limited partnership forms with directors duties giving priority to investors over shareholders.

7.5.1 Product manufacturers

Many investment research houses are paid by the product manufacturer. In some cases, they have been owned by a related party. This industry structure produces manifest conflicts of interest and consequently the research is not demonstrably independent.

Research houses and asset allocation consultants should be licensed as truly independent fiduciaries with SROs paying for the independent research costs, applying MiFID11 principles. Where a financial planning AFSL requires further opinion on the independent funds manager research, this to be a disclosed cost to the AFSL, not the client.

7.5.2 Custodians

Most Australian custodians act as transfer agents, in MIS acting on the instructions of the RE in accordance with the custody agreement and described in MIS PDS. They are not trustees (of any form), despite billing fees commensurate with the latter responsibility. The custodian is the legal owner of the fund assets. Assets can be custodially held or non-custodially held. The inference of a MIS having a custodian is that they are custodially held in trust. The custodian may only discover the existence of the assets for which they are custodian when there is a redemption. It is not clear that the custodian has a duty to report asset non-existence to the regulators.[159] That responsibility lies with the RE, but in the event of non-compliance, there is no custodial check, and therefore a failure of consumer protection.[160] In comparative jurisdictions, the custodial (depositary) requirement includes the 'monitoring of cash flows'.[161] Australian custodians do not have this responsibility. Other requirements include disclosure of portfolio interests.[162] The custodial function should include asset due diligence, whistleblower obligation, monitoring and reporting of transactions to Austrac.

The custody industry should be redefined and repriced into trust-based custodians and Transfer/Payment Agents. All custodians should be required to hold their own independent AFSL, be functionally independent, have fiduciary responsibility to the beneficial owner of the assets under custody, with regulatory capital reserve to match their reformed responsibilities. Eliminating related

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[159] Senate, PJC, Parliament of Australia, *Inquiry into the collapse of Trio Capital*, above n 155, 107.
[160] Submission to Senate, PJC, Parliament of Australia, *Inquiry into the collapse of Trio Capital* (2012), Committee Hansard, 23 September 2011 16 (Stephen Tudjman, General Counsel MLC National Australia Bank).
[161] Eilis Ferran, 'After the Crisis: The Regulation of Hedge Funds and Private Equity in the EU' (2011) 12 *European Business Organisation Law Review* 379, 401.
[162] Jennifer Payne, 'Private Equity and Its Regulation in Europe' (2011) 12 *European Business Organisation Law Review* 559, 579.

party custodian ownership harmonises Australian and international standards. It puts downward pressure on custodial fees.[163]

Elimination of custodial omnibus accounts reduces systemic risk, prevents conflicts of interest and ensures proper separation of investor property.

A custodian can sell its custody business to another custodian. When the custodian changes, so does the legal owner. This can have substantial adverse tax effects and in some jurisdictions, requires shareholder approval in that jurisdiction which may not be forthcoming. Transfer of ownership should mirror that proposed for transfer of (other) AFSLs.

7.5.3 Auditors

The *Corporations Act*, *SIS Act,* and *Fair Work (Registered Organisations) Amendment Act* are inconsistent, requiring harmonisation. All auditors should require registration consistent with the *Corporations Act*.[164]

7.6 Scale and critical mass in REs and RSEs

Fragmentation, compliance costs and fee income pressures, together with limited ability to source prudential and regulatory capital are leading to NBFE consolidation and vertical integration. To some extent this is being encouraged by APRA and ASIC, partly through administrative pressure. It follows that potential conflicts of interest will result. It also follows, that, as some superannuation funds internalise funds management operations, systemic risk will increase. In some cases, this is investment bank risk, the subject of considerable US statutory intervention for bank systemic risk in the *Glass-Steagall Act*.[165]

Industry consolidation can result in oligopolies. This is more likely in superannuation entities than other NBFEs, despite intervention to increase competition.[166] Industry funds are sectorally mandated with accompanying default funds with real competition limited to non-price product feature mechanisms.[167] Their market power would be enhanced by the impact of *Cooper* and its preference for libertarian paternalism. Logically, all superannuation entities will eventually become public offer funds. Harmonisation with international standards could result in inflows from other jurisdictions, a

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[163] Kevin Yi Liu, *Australian Superannuation: Operational Structure, Investment Performance and Trustee Governance* (PhD Thesis, The University of Sydney, 2013) 162.
[164] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 34, 2 [102]–[131] (Commissioner Heydon).
[165] *Glass-Steagall Act 1933* (US).
[166] *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004* (Cth).
[167] David Murray, *Financial System Final Report* (Australia Treasury, 2014) ['Murray'] 101.

desirable result if Australia wishes to become an international funds management centre. As with custody, this will also require the elimination of internationally uncompetitive fee structures.

7.7 Systemic risk: reform of the regulation of MIS

The systemic deficiencies in Australian MIS are much deeper than the poacher-gamekeeper paradigm and lack of prudential regulation. Present law facilitates egregious behaviour and provides limited investor protection from those behaviours, particularly for unregistered MIS. 'Market failure on such a scale that regulatory intervention is needed to remedy the shortcomings'.[168]

In Australia, there is no primacy of functional purpose over legal form. Trusts are used as large commercial trading enterprises. This is not the case in the US where legal convergence provides for substance over legal form. Much is made of the historic distinctions between a company (duty narrowly interpreted to shareholder owners) and trusts (duty narrowly interpreted to trustee-members). The concept of a company is much developed from its antiquarian origins. Similarly modern superannuation entities and MIS, structured as trusts can be large, ever growing complex financial businesses, often with direct and related party commercial activities, increasingly international in their scope, more akin to large commercial trading companies.

7.7.1 Liquidity

Many MIS investors have discovered to their chagrin that stated liquidity policy does not mean that they can recover funds. This also can apply to superannuation entities. Redemption policy normally assumes minimal redemption requests. Ponzi-like MIS and smaller superannuation entities with ageing beneficiary demographics are particularly vulnerable. Prudential supervision of superannuation entities now recognises the importance of longetivity risk with trustee directors required to account for that risk. MIS are not prudentially supervised despite their size and financing from superannuation entities, some being related parties.

7.7.2 The problem of unregistered MIS

All MIS should be registered: unregistered MIS should be abolished. There is a market need for small actively managed collective investment schemes, particularly in small scale property development and agriculture. These would be regulated using the Singapore Business Trust model which provides greater fiduciary protection to investors than Singapore CIS. Its Australian equivalent as a specific purpose NBFE can be provided by amending Part 5C of the *Corporations Act* and abolishing

[168] Senate Economics Reference Committee, Parliament of Australia, *Agribusiness managed investment schemes — Bitter Harvest* (2016) ch 6, 108 ['*Bitter Harvest*']

definition of registered MIS. Ie all collective investments are de facto registered MIS unless they come under the new active trust provisions. Further investor protection can be provided by extension of consumer finance law to these products.

7.7.3 The problem of insolvent MIS

Australian MIS are not subject to prudential regulation or supervision despite their size, commercial complexity, and systemic importance to the economy. There have been mismatches of cash flows, redemptions, liquidity for operations, reliance on leverage (sometimes multiple leverage), need for new investors to meet costs associated with older investors, all resulting in insolvency. To the extent that prudential risks are addressed at all it is the limited regulatory capital imposed on the RE, not the MIS. An RE can operate multiple MIS.

MIS capitalisation concerns date from 1993.[169] ASIC have had subsequent concerns.[170] The SLE proposal[171] for restricting the RE to a specific MIS would have improved investor protections arising from poor capitalisation of MIS and their RE, but was never adopted. The RE is typically only at risk for MIS capitalisation to the extent of the net assets of the MIS for which it is trustee, RE liability being contractually limited. Whilst RE regulatory capital requirements have increased, these are not necessarily available to the MIS, only to provide for orderly winding up of the MIS or transfer to a replacement RE.[172] RE regulatory capital requirements is not MIS prudential capital. Some REs cannot provide additional statutory regulatory capital: one factor in industry consolidation. More recent statutory intervention extends limited regulation to Non-Approved Deposit-Taking Institutions (Non-ADIs).[173] These are 'corporations which are engaged in the provision of finance, lending of money and origination of loans…'[174] Amendment of the *Banking Act* definitions to include Non-ADI' and inclusion of APRA data collection and directions powers[175] for the first time does not 'equate to ongoing regulation by APRA … [which] will not prudentially regulate and supervise non-ADI lenders as it does ADIs.[176] Neither does the legislation capture all of the NBFEs involved in

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[169] The Law Reform Commission, *Collective Investments and Other People's Money* (Report No 65, 1993) [23].
[170] Senate Standing Committee on Economics, Parliament of Australia, *Inquiry into forestry managed investment schemes* (September 2014) 13 [53].
[171] Australian Government, CAMAC, *Managed Investment Schemes* (Report, 2012).
[172] *Licensing: Financial Requirements* (ASIC Regulatory Guide 166, July 2015).
[173] Australian Government The Treasury, Treasury Laws Amendment (Non-ADI) Lender Rules) Bill 2017, Exposure Draft Explanatory Materials 6 [1.14]. Non-ADIs are defined as registrable corporations in the *Financial Sector (Collection of Data) Act 2001* (Cth).
[174] Ibid Explanatory Materials 6 [1.14].
[175] Ibid Explanatory Materials 5–6.
[176] Ibid Explanatory Materials 4 [1.12].

lending since many fall under the statutory quantum applied. These tentative steps fall far short of what is required.

For Australian financial products to be regionally competitive, ASIC should impose RE regulatory capital and MIS prudential capital similar to that applying for UCITS and IOSCO compliance in Singapore and Hong Kong. This is particularly important given Australian propensity for the use of trust structures in collective investment schemes. Unitholders may incur personal liability: 'There is no implied or deemed limitation of personal liability for a trustee…'[177][under Australian trust law]. For trust investors, where there is the 'ability to control or actually exert control, over the trustee or its business decisions…'[178] there is 'no equivalent statutory assurance of limited liability in the *Corporations Act*, or … elsewhere in the law applicable to trusts…'[179] In both cases, limitations of personal liability are attempted in contract, but there is 'no uniformity across the Australian market … some … display a lack of understanding of some important fundamentals'.[180] The Twin Peaks model of regulation and supervision should extend to all MIS.

7.7.4 The problem of Workers Entitlement Funds (WEFs) structured as MIS

WEFs are MIS but exempted on an annual basis by ASIC from operation of Part 5C of the *Corporations Act*, premised on workers' entitlements not being investor offers. Many charities, as Heydon points out, are companies. This fact is ignored. The WEF exemption should be discontinued and all registered organisations be subject to the *Corporations Act*.

7.7.5 The problem of poacher – gamekeeper in MIS: the RE as principal or agent

In most comparative jurisdictions, there is a separation of principle and agent. Australia is unique in allowing the corporate trustee to also be the MIS promoter, investment manager and operator. Related parties of the RE often have additional roles as landowner, manufacturer, harvester, marketer, and financier to investors in that MIS.[181] The tension between legal rights and economic interest is seen in the ownership structures of assets required for the proper operation of the MIS. In agribusiness MIS, it is rare for the MIS to own the land: it merely has a right of use, often limited, and often owned or leased from a related party of the RE. Land and other real assets (factories, processing facilities,

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[177] Nuncio D'Angelo, *Commercial Trusts* (LexisNexis Butterworths Australia, 2014) 187 [4.88].
[178] Ibid 150 [3.102].
[179] Ibid 118, [3.22].
[180] Ibid 193 [4.106].
[181] NZ has not adopted this Australian regulatory framework preferring the pre-1998 prescribed interest model of separation of responsibilities. This has not prevented the collapse of its finance company sector, the responsibility for which primarily rests on lack of prudential supervision and related party conflicts of interest and objectives.

assets required to produce, market and distribute MIS outputs) should be MIS property and held by an independent custodian or trustee.

International harmonisation will require Australia to return to the separation of trustee and promoter. Without that reversion, Australian NBFE financial products will find difficulty in attracting portfolio foreign investment and impossible to market in other jurisdictions. Where it does occur, mismatch of investor expectations and Australian practice is probable.[182]

Criticism that this will deter entrepreneurship is self-interested. The increase in the number of cases litigated since the advent of the *Managed Investments Act*[183] may be the result of increased endeavour, but also faulty implementation of that reform. It is not entrepreneurial for the economy to continually sustain direct losses set out in Table 3.17 and opportunity costs computed in Table 3.18.

7.7.6 Use of leverage in Managed Investment Schemes

A common strategy used by MIS promoters in Australia is to directly or indirectly provide financing to investors to fund their MIS capital investment and operating costs. Thousands of investors become substantially indebted (often a related party of the RE), without a saleable asset, ongoing liability to the MIS for management, maintenance and exit costs, and with recourse to their other assets often the family home. Related party financing should not have recourse to non-MIS other assets and no right of debt assignment to non-related entities. Prudential supervision will set limits on MIS leverage to reduce investor risk when borrowing MIS investment capital.

7.7.7 Management problems in Responsible Entities

A compliance plan is only as good as its drafting, its implementation by the compliance committee and the compliance plan auditor. Anecdotal evidence suggests problems with all three, and especially in a fragmented industry comprised of large numbers of small REs and where the MIS faces costs pressures. The compliance plan audit is to ensure that the compliance plan is current, not that it is effective,[184] and there are no standards against which a compliance plan auditor must conduct the audit. Directors and RE liabilities attach to contraventions of the plan, not its efficacy. The *Corporations Act* does not specify what constitutes adequate compliance. This responsibility is left to directors of the RE to create compliance measures tailored for specific MIS.[185] In practice,

[182] See, eg, Glaucus Research Group (2017) analysis of Tropical Forestry Services Ltd/Quintis.
[183] See above ch 3 tab 3.25.
[184] ASIC, Submission No 51 to Senate, PJC, Parliament of Australia, *Inquiry into the collapse of Trio Capital* (2012) 26.
[185] Ibid 31. See generally Alan Jessup, *Killing Bambi – Improving the effectiveness and efficiency of the legal and regulatory framework for protection of retail investors investing in collective investment schemes* (SJD

compliance committees do not provide real time monitoring (as in an internal audit capacity) and can lack independence.

7.7.8 Are Australian MIS Ponzi schemes?

ASIC think not,[186] but the microeconomics of many of them indicate that they are. Many rely on future investor subscriptions to fund operations properly attributable to earlier investors. In the absence of prudential supervision, the deficiencies in the MIS business model manifest as soon as new subscriptions to MIS unit slow or cease. Cash flow and liquidity deficiencies include reliance upon the RE (which can be conflicted, capital constrained, insolvent, or RE of multiple funds) for capital provision, use of leverage, investors funds not being held by an independent trustee or custodian, as well as reliance on future capital inflows to fund operations. Replacement of the RE for insolvency or conflicted interests is problematic, requiring costly private law actions which may result in adverse costs orders. The *Corporations Act* provides limited assistance (and none for unregistered MIS). Private actions have no indemnity recourse to MIS property.

For Australian MIS, there is no equivalent of the public trustee to act as replacement or temporary RE, and no replacement REs since they assume all of the liabilities of the former RE. These are systemic business and legal deficiencies in which ASIC should play a proactive role including the role of temporary RE. ASIC does not have the internal skills, but could fulfil this role using a panel of skilled contracted REs indemnified by it.

thesis application to University of Sydney, 2012); Alan Jessup, *Managed Investment Schemes* (Federation Press, 2012) 30.

[186] ASIC, Submission No 25 to Senate, PJC on Corporations and Financial Services, *Inquiry into Agribusiness Managed Investment Schemes* (July 2009) [88].

8. NBFE CORPORATE GOVERNANCE REFORM

8.1 Reconciling stakeholder interests and board competencies

There is considerable disharmony in Australia surrounding the governance of some NBFEs particularly industry superannuation funds. Some important reform attempts[187] have prevailed. Others have not.[188] Some superannuation entities are known to have egregious related parties and conflicts of economic interest. There is an unresolved conflict between perceived stakeholder interests and much-needed director and senior officer competencies. This conflict is politicised, legislative intervention highly contested, preventing rational reform. Many of these entities form significant proportions of the Australian capital market, operate globally, and some are assuming investment bank risk. Conflict and confusion arises from the different roles of representative stakeholders and board level competencies required to properly supervise management in meeting statutory and beneficiary objectives.

Cooper and Murray focussed on the need for financial expertise and professionalism of trustee board members over the present equal representation selection method,

> free of the type of conflicts that may cause them (either intentionally or unintentionally) [to] serve the interests of the [employer and employee] sponsors, a related party or a subset of members, rather than the fund's entire membership.[189]

'It is more important for directors to be independent, skilled, and accountable than representative'.[190] Empirical research supports this view: '[t]rustees lack experience, training or suitable knowledge, creating the potential for not fully understanding advice that they receive from outside experts.'[191] The politicisation of policy direction, as in this case, is clouded by antiquated ideas of the modern corporation and the modern trust, (including superannuation entities), and the role of directors.

Vested interest, resistance to change, based on spurious argument or misunderstanding clouds serious reform. The lessons of other jurisdictions where there are governance models which do give effect to

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[187] *Fair Work (Registered Organisations) Amendment Act 2016* (Cth).
[188] Superannuation Legislation Amendment (Trustee Governance) Bill 2015 (Cth).
[189] Senate, Economics Legislation Committee, Parliament of Australia, Superannuation Legislation Amendment (Trustee Governance) Bill 2015 2.5.
[190] Murray, above n 167, 135.
[191] Thi Thuy Chi Nguyen, Monica Tan and Marie-Anne Cam, 'Fund governance, fees and performance in Australian corporate superannuation funds a non-parametric analysis' (2012) 11(2) *The Journal of Law and Financial Management* 2, 7.

the interests of all stakeholders as well as to the responsibilities of directors and executive management have been ignored or lost in these Lilliputian conflicts.

Balancing stakeholder interests with supervision of management competencies has long been a feature of the German corporate governance environment.[192] Adopting this model in the context of Australian superannuation entities, and others controlled by representatives of registered organisations may provide a better model of governance of those entities and a solution to present policy conflicts. Emulation in some NBFEs,[193] without statutory support has not been successful but for different reasons. The 'advantage of the German system is the clear division of function'.[194] This separation of form and function echoes US governance reform promoted by the American Law Institute (ALI).[195] The supervisory board is the German equivalent of ALI preference for 'a majority of independent directors … free from any significant relationship with the corporation's senior executives'.[196]

Ultimately, the efficacy of governance in the Australian context will be a test of long term empirical performance. Performance is contested in Australia including in public advertising ('Compare the Pair' campaign). Empirical performance is related to cost structures as well as governance. Most NBFE's outsource functions,[197] but outsourcing costs 'is virtually identical for not-for-profit (both related [party] and independent) and retail funds that use independent service providers'.[198] This suggests that superior performance is driven by the competence of the director trustees. Scholarly Australian research notes that, in the superannuation sector, 'retail funds and not-for-profit funds exhibit different board characteristics and governance practices'.[199] [T]rustee directors' fund ownership, rather than their compensation, is an effective means of aligning the interests of trustees and members'.[200]

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[192] Klaus J Hopt and Patrick C Leyens, 'Board models in Europe – Recent Developments of Internal Governance Structures in Germany, the UK, France, and Italy' (2004) 2 *European Company and Financial Law Review* 135, 162.
[193] *Australian Securities and Investments Commission v Healey (No 1)* [2011] FCA 717 [300] (Middleton J).
[194] Grit Tüngler, 'The Anglo-American Board of Directors and the German Supervisory Board – Marionettes in a Puppet Theatre of Corporate Governance or Efficient Controlling Devices' (2000) 12(2) *Bond Law Review* 230, 269.
[195] Ibid 250.
[196] Ibid.
[197] Examples include administration, asset allocation, research, audit (statutory and compliance), custody, investment management, and asset management.
[198] Kevin Yi Liu, *Australian Superannuation: Operational Structure, Investment Performance and Trustee Governance* (PhD Thesis, The University of Sydney, 2013) 158, 164.
[199] Ibid 256.
[200] Ibid 279.

‘Since 2002, [German] company law requires both boards of listed German corporations to declare their conformity to the German Corporate Governance Code’.[201] Empirical analysis demonstrates that,

> the degree of compliance with the Code is consistently value-relevant information for the capital market…. Firms with a higher compliance are priced at an average premium … consistent with the hypothesis that there are capital market pressures (or at least incentives), suggesting a broad adoption of the Code…[202]

It implies foregone value to Australian NBFE securities holders and beneficiaries as a result of less optimal corporate governance practices.

Emulation of a two tiered corporate governance structure (Supervisory Board and Management Board) for NBFEs would reform Australian NBFE corporate governance in superannuation and MIS environments. The RE as trustee, effectively the supervisory board, would be separate from the management of the MIS. Stakeholders would appoint the supervisory board which then appoints and terminates a non-conflicted professionally competent management board. The voluntary Code of Trustee Governance for superannuation entities is not contested. It should be reviewed, become binding, and applied to other NBFEs, following the EU comply or explain paradigm.

8.2 Applying the German corporate governance model to Australia

The two tier board system achieves by governance design what Australia seeks to achieve by statute. It allocates authority to ‘alleviate conflicts of interest’.[203] Adopting this model in the context of Australian superannuation entities, and others controlled by representatives of registered organisations may provide a better model of governance of those entities and a solution to present policy conflicts.

How is reform to be implemented in Australia? What is the best mechanism to unlock economic benefits from governance reform in a contested political environment? ‘Conventional wisdom suggests parties on the left favour interests of stakeholders over shareholders’.[204] This has not always

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[201] Igor Goncharov, Joerg Richard Werner and Jochen Zimmerman, ‘Does Compliance with the German Corporate Governance Code have an Impact on Stock Valuation? An empirical analysis’ (2006) 14(5) *Corporate Governance: The international journal of business in society* 432.
[202] Ibid 442.
[203] Carsten Gerner-Beuerle and Edmund-Philipp Schuster, ‘The Evolving Structure of Directors’ Duties in Europe’ (2014) 15 *European Business Organisation Law Review* 191, 207.
[204] Helen Callaghan, ‘Insiders, Outsiders, and the Politics of Corporate Governance – How ownership structure shapes party positions in Britain, Germany, and France’ (2009) 42(6) *Comparative Political Studies* 733.

been the case in Australia, and is not the case in Germany. This provides a starting point for Australian reform: recognising in an uncontested way that reform objectives should be consistent with needs of beneficiaries in superannuation entities and securities holders in other NBFEs.

For Australian superannuation entities and workers entitlement funds (being special purpose MIS), the supervisory board would represent the beneficiaries — a representative board appointed by them supplemented by external independent appointments with specific competencies. They would have the same corporate trustee/RE functions as at present, but accountability directly to the beneficiaries. This direct accountability for superannuation entities is consistent with recent amendments to the *SIS Act*.[205] It would add accountability, presently missing, to Workers Entitlement MIS.[206] Beneficiaries would be in a position of determining, through their representatives, what is in their best interest. The management board would be appointed and dismissed by the supervisory board on the basis of skills sets and experience required to properly manage the entity. This model would eliminate the present conflicts within a unitary board paradigm between representation, conflicts of interest, and skills. Lack of knowledge and experience at board level is not unique to Australia: 'It has also been conceded by employees['] union officials that a lack of knowledge in the fields of accounting and finance amongst employee representatives can be observed'.[207]

These proposals are consistent with contested governance reform of Australian superannuation entities.[208] The importance of form matching function increases as Australian NBFEs invest internationally and for those which seek international investment. German style corporate governance is designed not only for 'the maximisation of shareholder value, but ensuring stability and growth'.[209]

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[205] *Superannuation Industry (Supervision) Act 1993* (Cth) ss 52(8), 29VN.
[206] Commonwealth, Royal Commission into Trade Union Corruption and Governance, *Final Report*, above n 34.
[207] Tüngler, above n 194, 238.
[208] Superannuation Legislation Amendment (Trustee Governance) Bill 2015 (Cth).
[209] Andreas Hackethal, Reinhard H Schmidt and Marcel Tyrell, 'Banks and German Corporate Governance: on the way to a capital market-based system?' (2005) 13(3) *Corporate Governance: The international journal of business in society* 397, 398.

8.3 Profession of director

Australian NBFE governance law is extremely complex.[210] International regulatory principles designed to improve corporate regulation and behaviour,[211]

> emphasise managerial and directorial responsibilities and community expectations of a more proactive regulation of corporations, aimed at the steady maintenance of standards and integrity and competence in corporate governance. They reflect the view that participation in corporate governance is a privilege enjoyed by individuals subject to compliance with conditions. It is not a private right to be defended, as such, by notions such as the penalty privilege.[212]

These important statements link the will of Parliament for an internationally competitive economy through recognised standards of corporate governance with the *Corporations Act*, other statutes and their interaction with the general law.

> This court should uphold, and not frustrate, the will of Parliament. It protects very important social and economic purposes. …[213] That this court did impose a common law interpretation on that 'clearly expressed will' … seriously impedes the attainment of the Act's important purposes for corporate governance in this country. …[214] It contradicted the 'primacy of statute' and, by inserting judicial protections for managers, 'undermines the provisions of the Act',[215]

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[210] See, eg, Drummond AJA in *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [2051]: 'The impacts of corporate decision-making on a wider range of interests than shareholders are now being given more recognition. The need to ensure protection of those interests also I think serves to explain why modern company courts have become more interventionist, in reviewing the activities of directors than was traditionally the case'; See also, Commonwealth, HIH Royal Commission, *The Failure of HIH Insurance Final Report* (April 2003) (Commissioner Owen) quoted in R A St John, CAMAC, *Corporate Duties below board level* (Report, April 2006) 47: '[t]he uncertain state of the law in this area has been a source of difficulty in my assessment of those cases where there might have been a breach of the law ... '. As Kirby J acknowledged in *Rich v Australian Securities and Investments Commission* [2004] HCA 42 [116]-[117], 'Such were the demonstrated abuses and errors in the management of Australian corporations in the 1980's that widespread demands were made for an end to complacency and for an attack on "bad corporate governance" being systemic "serious danger to the economy of the nation inherent in the multiple corporate collapses of the 1980's, repeated in equally spectacular form in more recent years"'. See also, Justice Michael Kirby, 'The company director: past, present, and future' (Speech delivered at the Australian Institute of Company Directors, Tasmanian Division, Hobart, 1998). See generally Du Plessis, 'Reverberations after the HIH and other recent corporate collapses: the role of ASIC', (2003) 15 *Australian Journal of Corporate Law* 225.

[211] Organisation for Economic Cooperation and Development, *Principles of Corporate Governance* (1999); See also Jillian Segal, 'Corporate Governance: substance over form' (2002) 25 *University of New South Wales Law Journal* 320.

[212] *Rich v Australian Securities and Investments Commission* [2004] HCA 42 [119] (Kirby J).

[213] Ibid [132] (Kirby J).

[214] Ibid.

[215] Ibid [115] (Kirby J).

in this case by favouring the personal rights of directors. These were dissenting views, but qualified:

> Most matters involving statutory construction – including as it relates to pre-existing principles of equity and the common law – are contestable by the time they reach this Court. Upon many such questions there is no absolutely correct decision, certainly in the objective sense.[216]

The statutory intent was 'turned, instead, into one addressed to the principles of the common law affording a privilege in certain circumstances against exposure to penalties or forfeiture'.[217]

These statements go to the heart of systemic failure in the regulation of NBFEs in Australia. Uncertainty of the law leads Australia to the position in which it finds itself today. It is not only directors and trustees who are frustrated by uncertainties in the law.[218]

> Especially in an Act as large and cumbersome as that under consideration (with its history of patchwork accretions), it is impossible to be confident. …[219] The construction of the Act now adopted needlessly restricts the Commission [ASIC] and the court in trying the claim. …[220] Doing so seriously impedes the Act's important purposes for corporate governance in this country.[221]

A culture of retribution is now embedded in the general law relating to director and trustee disqualifications and enforcement actions. It is punitive and serves to diminish entrepreneurial endeavour. The author's qualitative research reports board paralysis. Cases of corporate failure often result in public examinations of the directors who can be held up to ridicule, contempt, even when there is no breach of duty. A doctrinal approach should be rehabilitative.

Daniels v Anderson[222] is commonly cited to differentiate between the responsibilities of executive and non-executive directors. The judgments are rather more insightful into why Australia's corporate governance environment is systemically weaker than in other jurisdictions and what should constitute a competitive corporate governance regime.

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216 Ibid [74] (Kirby J).
217 Ibid [61] (Kirby J).
218 Allens Linklaters, *Mergers and Acquisitions Focus: Corporate Governance* (March 2003).
219 *Rich v Australian Securities and Investments Commission* [2004] HCA 42 [122] (Kirby J).
220 Ibid [132] (Kirby J).
221 Ibid.
222 *AWA Ltd v Daniels t/a Deloitte Haskins & Sells* (1992) 7 ASCR 959; 10 ACLC 933 NSWSC; *Daniels formerly practising as Deloitte Haskins & Sells v AWA Ltd* (1995) 37 NSWLR 438; 13 ACLC 614 NSWCA.

> It is an anachronism to expect non-executive directors, meeting once a month, to contribute anything much more than decisions on questions of policy. The non-executive directors relied and were entitled to rely on management and the auditors.[223]

Doubtless, there are many directors who subscribe to this view. However, the distinction was not to last: there is no history of unanimity. In a dissenting opinion:

> The time has passed when directors and other officers can simply surrender their duties to the public and those with whom the corporation deals by washing their hands, with impunity, leaving it to one director or a cadre of directors or to a general manager to discharge their responsibilities for them.[224]

Older concepts of sleeping or passive directors are obsolete.[225] The general law has attempted to define the responsibilities of a board: goals, CEO appointment, oversight of management, and monitoring progress.[226] These duties are akin to the roles of the German supervisory board. Unlike German supervisory boards, the role of the non-executive director of an Australian NBFE is not defined in a manner that allows its discharge on a non-executive basis in statute or general law. [227]

The general law affirms the lack of distinction between executive and non-executive directors and the inability of non-executive directors to rely upon management and adviser delegation: 'the non-executive directors relied "completely" and "solely" on management, their advisors, and the processes in place'.[228] A director can delegate subject to statutory provisions.[229] Emulation of the German corporate governance model, tentative as it was in *Healey*, would provide relief.

[223] Bob Austin, 'Company Law – Some Notes on Significant Cases' (Paper presented at the 12th Annual Company Secretaries Conference, 17 October 1995); See also Rogers J, writing extra-curially, 'Daniels v AWA: facts' (July 1996) 48(6) *Australian Company Secretary* 231.
[224] *Metal Manufacturers Pty Ltd v Lewis* (1988) 13 NSWLR 315 [318]–[319] (Kirby J).
[225] Austin, above n 223. See also *Rich v Australian Securities and Investments Commission* [2004] HCA 42 (Rogers J).
[226] *AWA Ltd v Daniels (t/a) Deloitte Haskins & Sells)*(1992) 7 ASCR 759.
[227] *AWA Ltd v Daniels (t/a Deloitte Haskins & Sells)* (1992) 7 ASCR 759 [865]. Companies legislation has not sought to determine the proper division of functions between the board and management. Instead, it evolved in response to the demands of changing company structures and commercial practices. … The board of a large public corporation cannot manage the corporation's day to day business. That function must be left by necessity left to the corporation's executives. The directors rely on management to manage the corporation. The board does not expect to be informed of the details of how the corporation is managed.
[228] *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291; [2011] FCA 717 [569], [580], [582] (Middleton J).
[229] *Corporations Act 2001* (Cth) ss 198A(1), 198D; *Superannuation Industry (Supervision) Act 1993* (Cth) s 59.

What should directors actually do? What does ‘all reasonable steps’ mean in practice? [230] It means an objective analysis of each case: ‘the standard requires, at a minimum, that directors take a diligent and intelligent interest in the information either available to them or which they might appropriately demand from the executives or other employees and agents of the company’.[231] Whilst this standard is derived from consideration of insolvency cases, the law is replete with references to reasonable.

‘“[R]easonable steps” must be made in the circumstances of as they were at the time, rather than with the benefit of hindsight’.[232] Standards evolve. The evolution of the reasonable steps requirement requires careful consideration by directors and particularly to the extent to which they can rely on specialist advice from senior management and auditors.[233] In the UK, ‘a director will not be found liable of an offence unless he or she fails to take reasonable steps to secure compliance and had knowledge that the accounts did not comply with the Act, or was reckless as to that fact’.[234]

The *SIS Act*[235] prescribes standards applicable to the operation of superannuation entities including the disclosure of significant information to fund beneficiaries. The trustee of a fund ‘must give information to a member concerning any event in relation to the fund that the trustee reasonably believes the member would reasonably be expected to be informed of.’[236] There are standards for trustees, custodians and investment managers.[237] There are also specific standards for actuaries and auditors.[238] If the governing rules of the fund do not contain the statutorily prescribed covenants, then they are taken to contain them.[239] These covenants extend to the trustee directors personally, which is not the case for directors of entities which are not trustees of superannuation entities including MIS.

These governing rules ‘must not permit the trustee to be subject, in the exercise of any of the trustee’s powers under those rules, to any direction by any other person’,[240] and if they do, ‘they are invalid’.[241] Trustees have ‘no right to shift their duties on other persons’.[242]

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[230] *Australian Securities and Investments Commission v Healey (No 1)* [2011] FCA 717 [146] (Middleton J); *Corporations Act 2001*(Cth) s 295(4).
[231] *Australian Securities and Investments Commission v Healey (No 1)* [2011] FCA 717 [143] (Middleton J).
[232] Ibid [149] (Middleton J).
[233] *Ministry of Economic Development v Feeney* (2 August 2010) NZDC (Auckland CRI-2008-044-29199).
[234] *Companies Act 2006* (UK) s 414(4).
[235] *Superannuation Industry (Supervision) Act 1993* (Cth) pt 3.
[236] *VBN and Australian Prudential Regulation Authority* [2006] AATA 710 [13] (S A Forgie, V-P and B H Pascoe).
[237] *Superannuation Industry (Supervision) Act 1993* (Cth) pt 15.
[238] Ibid s 130.
[239] Ibid s 52(2).
[240] Ibid s 58(1).
[241] Ibid s 58(3).
[242] *Turner v Corney* [1841] ER 1192.

That statutory intervention has been required to support established general law duties speaks loudly of the need for reform of standards of directors and trustee qualifications. Codification does not mean knowledge and comprehension. It only means the legislature addressed a problem. It does not mean the problem is resolved. Indeed it is not: corporate governance of Australian NBFEs requires substantive reform.

8.4 Fit and Proper Test: Probity and competence

There is no recognised profession of director from which to draw. 'After 25 years the gene pool for super funds is showing signs of in-breeding. It is time for more diversity on boards'.[243]

In practice, and in contrast with other jurisdictions, fit and proper testing rarely goes beyond police and public record checks for the majority of appointees and reliance upon good character or at least the absence of adverse public record. Traditionally, in Australia, there are few statutory, academic, business, or other qualifications required to be appointed as a director of Australian public or proprietary companies.[244]

International harmonisation will require: mandatory professional training for directors and trustees with professional accreditation; continuous professional development including microeconomics, strategic and business planning, and ethics; significantly enhanced educational and professional experience for trustees and directors of trustees in fiduciary obligation; and, fit and proper examinations that focus on skills, experience and competence: traditional probity checks are not sufficient.

8.5 Business Judgment: Rule or Doctrine?

Situations occur regularly where directors must exercise their business judgment. There would be many directors who favour a strengthened business judgment rule in Australian law. But there is a distinction between entrepreneurship and much of the market conduct evidenced in the empirical analysis of Australian cases. However, given that the economy needs directors and boards who are entrepreneurial (a reason for the original concept of the corporation), a statutory business judgment rule that purports to protect directors may not be the best mechanism for balancing entrepreneurial

[243] M Scott Donald, 'Super needs new breed of independent directors', *Australian Financial Review* (Sydney), 6 November 2014.

[244] Santow J in *ASIC v Adler* [2002] NSWSC 483 [56]: 'In assessing the fitness of an individual to manage a company, it is necessary that they have an understanding of the proper role of the company director and the duty of due diligence that is owed to the company'. See also *ASC v Donovan* (1998) 28 ACSR 58, 607 (Cooper J).

risk seeking strategy with director responsibility.[245] An economy needs its entrepreneurs for society to prosper. However, entrepreneurs, like all market participants, need to operate within the framework of the Law Matters thesis as part of the trust requirement. That this trust has largely been lost in Australia diminishes an entrepreneurial economy, now quantified.[246] Statutory intervention into business judgment should be designed to protect and enhance value outcomes rather than mere protection for directors and officers. Prescriptive statute has not achieved that nor recognised that there is risk in every investment. A doctrinal approach, as in Singapore, Canada and Germany, may better suit a fiduciary environment.

Should Australia adopt German governance standards, its objectives can be sustained by significantly improving the qualifications and standards of directors, providing appropriate resources to enable them to carry out their functions, making directors proactively responsible for receipt of necessary information, provide them individually with the right to convene directors meetings and requiring mandatory participation of auditors in those meetings.

These conditions are part of business judgment doctrine. No useful purpose is served by judicial emasculation of the BJR. Its role and effectiveness require review. It still does not provide relief in insolvency situations, despite limited recent reform. Nor does a codified BJR sit easily with culturally different and complex cross-border business. Broad economic policy encouraging entrepreneurship with statutory intervention to prevent director and trustee flight, following US and UK examples, may be better than a codified BJR. Singapore adopts the doctrinal model, as does Germany, requiring no violation of duty of care and loyalty principles. Directors and trustees must proactively search for, adequately source, explain, control and ensure comprehension by the recipients of information. A pure personal liability environment, conducive to fostering true entrepreneurship based on truth, wisdom and acceptance of responsibility.

8.6 Board practices

Directors and trustees must have the required resources of time, information and advice to perform their functions. The cases illustrate failures in Australian NBFE board practices which conflict with a reformed business judgment doctrine. These cases include: complexity and timeliness of board papers; stability of those papers; ability to pursue their diligent study; and document retention. These

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[245] Lord Wilberforce, 'Law and Economics' in P W Harvey (ed), *The Lawyer and Justice* (Sweet and Maxwell, 1978) 73; See also J A Priestly and M D Kirby, 'Rethinking Company Law and Practice' (1995) 5 *Australian Journal of Corporate Law* 176.

[246] See above, ch 3.

are procedural failures: liability without resources. Board practices can be guided as part of a reformed business judgment doctrine. Existing governance codes do not suffice.

9. IMPLEMENTATION OF THE REFORM STRATEGY

Whither Australia?

Australian public policy is at a cross-roads. 2018 is the end of the financial reform period which commenced in 1981. There is a considerable risk that the egregious behaviour described in this thesis and for commercial banks and other entities examined in the Hayne Royal Commission[247] will result in more statutory intervention, a less entrepreneurial economy, higher costs and reduced availability of capital, and fewer market participants. Perhaps not a return to oligopoly, but nonetheless more restrictive and less internationally competitive. Conversely, the Productivity Commission proposes to extend ASIC's mandate to competition.[248] Whilst acknowledging the need for substantive ASIC reform,[249] it proposes to repeat the error identified by Ashby in 2009 following UK regulator reform in 2007: 'our regulators have been part of the problem'.[250]

2018 is the end of the beginning of modern Australian financial reform. Choice of road is at hand. Parliament must decide. It must be presented with alternative options. One option will stem from the Hayne Royal Commission. This thesis presents another option: it proposes the 'Age of Statutes' evolve to the 'Age of Trust', firmly rooted in the fertile soil of Scott Donalds' 'nobler qualities'[251] of fiduciaries. Those fiduciary qualities are implicit in community expectation of trust and loyalty on whom they rely, forming the basis of a modern regulatory regime.

What does Australia wish to achieve as a modern nation? Does it wish to develop its modern story as an entrepreneurial economy competing with its global peers? Does it remain largely reliant on resources extraction and low value employment? Does it want to leverage off innovation and skills? Does it want to develop its SME sector? The answers to these questions determine future public policy in financial services and products regulation. Egregious conduct is contagious. It becomes part of the culture. Does Australia continue its tradition of statutory accretion which has allowed it to flourish? Or do the insights in this thesis provide a framework? This the cross-road that Parliament must now traverse. It is a binary choice.

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[247] Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Commissioner Hayne).
[248] Australian Government Productivity Commission, *Competition in the Australian Financial System* (Draft Report, January 2018).
[249] Ibid 24.
[250] Simon Ashby, *The Turner Review on the Global Banking Crisis: A Response from the Financial Services Forum* (Nottingham University, 2009) 33. See above ch 5 s 3.3.2.
[251] Donald, 'Regulating for fiduciary qualities of conduct', above n 43, 142 [1].

If the former road, then this thesis predicts that the future will be similar to the recent past. If not, then Australia must undertake reform of financial regulation as proposed in this thesis. Entrepreneurial freedoms must be matched by participant acceptance of fiduciary obligation to guide and enforce market conduct standards: the two are symbiotic. This is evolutionary, some may say revolutionary. It is not revolutionary: it returns Australian financial regulation to a positive culture of trust, honesty and fair dealing.[252] That is a culture that provides for entrepreneurship, business growth and future employment.

The Law Matters: its manifest deficiencies have been one reason for the paucity of global firms originating or based in Australia. This has led to fewer on-shore investment opportunities for superannuation funds, capital flight to other jurisdictions, entrepreneur flight, suboptimal GDP growth, reducing skilled employment opportunities for the population. Australia:

> needs a system that evades the risk aversion that has become common practice and returns to our roots as an entrepreneurial community breaking new barriers. In the 21st century regulation needs to avoid paternalism without completely abandoning prudent protection of interest.[253]

It is not merely a matter of law, something missed by those who prescribe statutory remedy for every ill. That is the easier route: the quick fix, the instant medication. Evolution is rarely accidental: it is a response to environmental change and the opportunities afforded by new niches. This is the more thoughtful route, taking time to effect cultural change.

Implementation of the four reform themes will require national leadership: from Parliament given form by the Executive. It will require four implementation teams for four years: stakeholder support is essential. Some of these will overlap. A senior Parliamentary ministerial champion supported by a special purpose Reference Group with Commonwealth financial support is required. It could be based on the inoperative but extant Financial Sector Advisory Council. Implementation should be considered as a decade long policy objective working in tandem with the Council of Financial Regulators (CFR). The CFR should have an enhanced mandate to supervise implementation within its regulator stakeholder group. Within each theme, specific tactical legislative interventions in disclosure, national productivity strategy, and governance are needed. The CLERP provides a

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[252] See, eg, *Bray v Ford* [1895–99] All ER 1009, 1011. Lord Herschell noted that: 'human nature being what it is, there is a danger … of the person holding a fiduciary position being swayed by interest rather than duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to la[y] down this positive [inflexible] rule.'

[253] Australian Association of Angel Investors, *Equity Crowdfunding; Response to the Treasury Consultation Paper* (2015).

precedent. These four themes will require considerable statutory support, for consistency guided by the Reference Group and the responsible minister. The Reference Group should sponsor and supervise an independent arbiter to reduce dependence on the court system. The CFR will consider and publicly explain in a comprehensive transparent way what the impact of the reform themes are. It is:

> a vehicle for improving regulators' ability to influence expectation in financial markets. It can build trust in the actions of regulators. But of greatest value is its capacity to be a forum that can test the proposition of a macroprudential intervention….[254]

This is consistent with the need for a competition advocate. Competition should be seen as part of the overall thematic reform program, not separate from it. 'For ASIC to act as a champion of financial system competition would require a clear change … and a change in its regulatory culture'.[255] Presently, there is no 'framework or a process for effective external review of the performance of its [Australian government] financial regulators'.[256] This was also proposed by Murray,[257] who recommended updating the Statements of Expectations of ASIC and APRA.

ASIC does not have a history of self-imposed reform in its governance, despite external recommendations by Uhrig in 2003, the ASIC Capability Review in 2015 or human resourcing constraints identified by Murray in 2014. Those expecting reform are therefore likely to be disappointed. Mandate extension without necessary reform is another Australian example of the 'poacher being the gamekeeper'. The Capability Review also identified deficiencies in ASIC's strategic abilities. These extend 'towards advancing *consumer's* interest in financial products … That it has not already done so is of concern'.[258]

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[254] *Ministry of Economic Development v Feeney* (2 August 2010) NZDC (Auckland CRI-2008-044-29199) 476. This refers specifically to a competition advocate but can be applied more broadly to each of the reform themes and their tactical manifestations.
[255] Ibid pt 4, 418.
[256] Ibid s 15.2, 424.
[257] Ibid s 17.2, 479. Murray proposed the establishment of a Financial Regulator Assessment Board. The Productivity Commission argue that there is 'no compelling case for a "regulator to regulate the regulators"'. See Ibid 480.
[258] Ibid 24.

Some stakeholders will be challenged: others, the qualitative research identifies, will be supportive. All stakeholders must focus on the needs of investors and beneficiaries in the investment chain, not their own sectoral interests. There must be commonality of objective disciplined by a financially empowered literate community led by champions.

Is Australia up to the challenge?

10. POSTSCRIPT

If the predictive veracity of the empirical data in this thesis is correct,[259] then the media reporting of egregious behaviour uncovered by the Hayne Royal Commission and in the Productivity Commission Draft Report should give great cause for concern. Reporting indicates that there is substantial continent risk in superannuation and non-superannuation NBFEs as posited above.[260] These cyclical manifestations have deep systemic causes.

As Hayne notes,

> given the existing breadth and complexity of the regulation of the financial services industry, adding any new layer of law or regulation will add a new layer of compliance cost and complexity. […] [T]here is every chance that adding a new layer of law and regulation would only serve to distract attention from the very simple ideas that must inform the conduct of financial services entities.[261] [...] These ideas are very simple. Their simplicity points firmly towards a need to simplify the existing law [...] in the blizzard of [statutory] provisions, it is too easy to lose sight of those simple ideas that must inform the conduct of financial services entities.[262]

The calls for this Royal Commission stemmed from 2014.[263] Much of the case study material is old news.[264] Its mandate and lifespan are limited and should be extended to all NBFEs. Hayne distinguishes between 'ticking boxes' and '[w]hat is the *right* thing to do?'[265] The '*right* thing' meets community expectations of fiduciary obligation in the investment chain.

The Productivity Commission is mandated to improve competition in financial services and products provision as a disciplinary policy tool to improve consumer outcomes. It acknowledges the need to balance financial stability and competition. It also recognises the practical limits of disclosure regulation, limited financial literacy competencies, recognising that behavioural economics provides important insights into policy formulation.[266] These practical limitations are exacerbated by conflicts

[259] See above ch 3 s 3.9.
[260] See above ch 1 s 1.2.
[261] Hayne's 'simple ideas' are to: '[o]bey the law. Do not mislead or deceive. Be fair. Provide services that are fit for purpose. Deliver services with reasonable care and skill. When acting for another, act in the best interests of that other.'
[262] Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, above n 247, vol 1 290.
[263] Senate Economics Reference Committee, Parliament of Australia, *Performance of the Australian Securities and Investments Commission* (June 2014).
[264] See above ch 2 s 6.1.
[265] Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, above n 247, vol 1 290
[266] Australian Government Productivity Commission, *Competition in the Australian Financial System* (Draft Report, January 2018) ch 2, 85; pt 111, 352–356.

of interest, particularly in vertically integrated businesses, proposing a ‘legal duty of care’.[267] Canadian and German models thus become both relevant and insightful.

That proposed duty includes design of a 21st century disclosure regime[268] where ‘consumers resort to making decisions based on trust’.[269] For the Productivity Commission to achieve this policy objective, fiduciary obligation to quality assure the investment chain is an essential and inviolable precondition.

It is unfortunate that the analysis of best interests obligations of financial advisers under the FoFA regime is incomplete.[270] An uninformed reader might assume this is a statement of the law, which would be incorrect. Similarly, whilst a useful analysis of investor typology, there are no clear proposals for reform.[271] It is equally unfortunate to propose extending ASIC’s mandate without an agreed plan to reform it. For ASIC to adopt a supervisory proactive posture will require its substantive reform. The Commission merely proposes further examination.[272]

[267] Ibid ch 8, 227.
[268] Ibid pt 111, 347, 366.
[269] Ibid pt 111, 355.
[270] Ibid app D3, 557.
[271] Ibid 560.
[272] Ibid ch 7, 473.

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APPENDIX 1: PHD QUALITATIVE RESEARCH — CAUSES OF SYSTEMIC FAILURE

Sources of failure identified by interviewees	*No of responses Melbourne*	*% Melbourne*	*No of responses Sydney*	*% Sydney*	*No of responses Brisbane*	*% Brisbane*	*Total responses*	*Total %*
n=	**5**		**17**		**6**		**28**	
Intrusion of 'black' letter law	4	**80.00%**	6	35.29%	4	**66.67%**	14	**50.00%**
Smart lawyer manipulation of complex 'black letter' law	2	40.00%	4	23.53%	3	**50.00%**	9	**32.14%**
Financial regulation in isolation: accretive tinkering: need trust principles	1	20.00%	10	**58.82%**	5	**83.33%**	16	**57.14%**
Leverage and margin lending to retail investors	1	20.00%	4	23.53%	1	16.67%	6	21.43%
Financial planning not a profession	3	**60.00%**	7	41.18%	3	**50.00%**	13	**46.43%**
Financial planners should have unqualified best interest duty to client		0.00%	5	29.41%	4	**66.67%**	9	**32.14%**
Ignorance of social licence to practice as a professional	2	40.00%	2	11.76%	1	16.67%	5	17.86%
Related party transactions	5	**100.00%**	8	**47.06%**	4	**66.67%**	17	**60.71%**
Conflicts of interest - related trustees & investment managers/promoters/advisers	3	**60.00%**	8	**47.06%**	3	**50.00%**	14	**50.00%**
Remuneration of funds managers encourages more risk	1	20.00%	1	5.88%	1	16.67%	3	10.71%

Sources of failure identified by interviewees	***No of responses Melbourne***	***% Melbourne***	***No of responses Sydney***	***% Sydney***	***No of responses Brisbane***	***% Brisbane***	***Total responses***	***Total %***
Box ticking regulation by ASIC	3	**60.00%**	6	35.29%	4	**66.67%**	13	**46.43%**
Ineffective leadership at ASIC/ wrong leadership motivations	2	40.00%	6	35.29%	2	33.33%	10	**35.71%**
Registered Organisations should be regulated as companies	3	**60.00%**	1	5.88%	2	33.33%	6	21.43%
Poor ethical standards	1	20.00%	5	29.41%	2	33.33%	8	28.57%
Too many related parties 'clipping the ticket'	4	**80.00%**	1	5.88%	2	33.33%	7	25.00%
Black letter' law cannot be applied to culture	1	20.00%	2	11.76%	1	16.67%	4	14.29%
Poor director and trustee training & expertise	3	**60.00%**	3	17.65%	2	33.33%	8	28.57%
Trustees process driven as self protection mechanism - high risk profile for trustees	2	40.00%		0.00%	1	16.67%	3	10.71%
Gender balance policies leading to suboptimal board appointments	1	20.00%		0.00%	1	16.67%	2	7.14%
Custodians poor performers	1	20.00%	2	11.76%		0.00%	3	10.71%
Appearances of probity only: self interest rules	1	20.00%	6	35.29%	4	**66.67%**	11	**39.29%**
Reliance on ratings agencies	2	40.00%	1	5.88%		0.00%	3	10.71%

Sources of failure identified by interviewees	*No of responses Melbourne*	*% Melbourne*	*No of responses Sydney*	*% Sydney*	*No of responses Brisbane*	*% Brisbane*	*Total responses*	*Total %*
Government interventions increase complacency, increase risk, & poorer asset allocation	2	40.00%		0.00%		0.00%	2	7.14%
Separate commercial core activities from investment banking (banks & super funds)	2	40.00%	2	11.76%		0.00%	4	14.29%
Impact of impairment charges result in covenants breaches although entity solvent	2	40.00%		0.00%		0.00%	2	7.14%
Conflicts of interest - insolvency profession acting as cartel under control of banks	1	20.00%	1	5.88%		0.00%	2	7.14%
APRA is politicised	5	**100.00%**	3	17.65%	1	16.67%	9	**32.14%**
APRA chases minor infractions, stubborn, not a creative regulator, not accountable	5	**100.00%**		0.00%	1	16.67%	6	21.43%
APRA 'best of breed'		0.00%	1	5.88%	1	16.67%	2	7.14%
ASIC is politicised & reform resistant	1	20.00%	5	29.41%	2	33.33%	8	28.57%
ASIC brief is too broad	1	20.00%	3	17.65%	3	**50.00%**	7	25.00%
ASIC has no clear strategic role		0.00%	5	29.41%	2	33.33%	7	25.00%
Regulators unwilling to learn from mistakes; stubborn; shy of scandal	2	40.00%	2	11.76%	1	16.67%	5	17.86%

Sources of failure identified by interviewees	***No of responses Melbourne***	***% Melbourne***	***No of responses Sydney***	***% Sydney***	***No of responses Brisbane***	***% Brisbane***	***Total responses***	***Total %***
ASIC has no institutional memory		0.00%	2	11.76%	2	33.33%	4	14.29%
ASIC compliance reviews positive and assisted business: bottom up approach		0.00%		0.00%	1	16.67%	1	3.57%
ASIC doesn't give definitive advice		0.00%	3	17.65%	2	33.33%	5	17.86%
ASIC is scary, expensive and lacks common sense		0.00%	3	17.65%	2	33.33%	5	17.86%
Lack of transparency and accountability in RO/FWC	2	40.00%	4	23.53%	3	**50.00%**	9	**32.14%**
Lack of transparency and accountability in regulators	2	40.00%	2	11.76%	2	33.33%	6	21.43%
Regulators and boards need experts, good culture, insight, not lawyers	2	40.00%	4	23.53%	2	33.33%	8	28.57%
Boards need more independent minds	2	40.00%	3	17.65%	4	**66.67%**	9	**32.14%**
Legalised theft	1	20.00%	3	17.65%	4	**66.67%**	8	28.57%
Australian financial sector not internationally competitive in structure or fees	1	20.00%	7	41.18%	2	33.33%	10	**35.71%**
Lack of financial literacy partly laziness, not all education	1	20.00%		0.00%	3	50.00%	4	14.29%
Adviser financial literacy often flawed		0.00%	7	41.18%	2	33.33%	9	**32.14%**
Roboadvice flawed: electronic Storm Financial model		0.00%		0.00%	1	16.67%	1	3.57%

Sources of failure identified by interviewees	*No of responses Melbourne*	*% Melbourne*	*No of responses Sydney*	*% Sydney*	*No of responses Brisbane*	*% Brisbane*	*Total responses*	*Total %*
Investor expectations not matched with regulator mandate or performance	1	20.00%	3	17.65%	2	33.33%	6	21.43%
Disclosure documents do not include management discussion		0.00%	2	11.76%	1	16.67%	3	10.71%
Parliamentary expertise lacking		0.00%	1	5.88%	3	50.00%	4	14.29%
Problem is enforcement		0.00%	3	17.65%	1	16.67%	4	14.29%
Strict rules may provide disincentive to comply		0.00%	1	5.88%		0.00%	1	3.57%

Remedies & sanctions proposed by interviewees	*No of responses Melbourne*	*% Melbourne*	*No of responses Sydney*	*% Sydney*	*No of responses Brisbane*	*% Brisbane*	*Total responses*	*Total %*
Extension of criminal sanctions	1	20.00%	2	11.76%	1	16.67%	4	14.29%
Need for common sense, honesty, and better culture		0.00%	4	23.53%	4	**66.67%**	8	28.57%
Commissions only to be paid on net results at end of investment	1	20.00%	1	5.88%	1	16.67%	3	10.71%
Ban commissions to financial advisers	1	20.00%		0.00%	2	33.33%	3	10.71%
Stockbrokers and accountants should be financial advisers	1	20.00%		0.00%		0.00%	1	3.57%
Financial planners to become educators		0.00%	2	11.76%	3	**50.00%**	5	17.86%
Reform of vertical integration models	2	40.00%	1	5.88%	1	16.67%	4	14.29%
Reform of AFSLs - eliminate 'treaty shopping'		0.00%		0.00%	1	16.67%	1	3.57%
All to be subject to fiduciary principles		0.00%	12	**70.59%**	2	33.33%	14	**50.00%**
Reform of related party transactions (Prohibition No; transparency; best interests tests)		0.00%	4	23.53%	2	33.33%	6	21.43%
Better remuneration structure for trustees: need to be funded properly	1	20.00%		0.00%		0.00%	1	3.57%
Social licence to be enforced through extension of fiduciary principles	2	40.00%	1	5.88%	1	16.67%	4	14.29%
International harmonisation to generate reform	2	40.00%	1	5.88%	1	16.67%	4	14.29%

Remedies & sanctions proposed by interviewees	*No of responses Melbourne*	*% Melbourne*	*No of responses Sydney*	*% Sydney*	*No of responses Brisbane*	*% Brisbane*	*Total responses*	*Total %*
APRA supervision model and HR to be emulated by ASIC and RWRO	1	20.00%	1	5.88%		0.00%	2	7.14%
Rotation of board appointed specialists (cf auditors)	1	20.00%		0.00%		0.00%	1	3.57%
Adopt German style two tier board structure	2	40.00%		0.00%		0.00%	2	7.14%
University standard training of directors and trustees (eg UK model; CPA model Aust.)	3	**60.00%**	1	5.88%	1	16.67%	5	17.86%
Directors need access to funds for independent non management advice		0.00%		0.00%	1	16.67%	1	3.57%
Ban trustee and promoter related parties	2	40.00%	3	17.65%	2	33.33%	7	25.00%
Independent trustees	1	20.00%		0.00%		0.00%	1	3.57%
Limit retail investor access to financial products	1	20.00%		0.00%		0.00%	1	3.57%
Complete independence of Ratings Agencies & eliminate conflicts of interest	1	20.00%	1	5.88%		0.00%	2	7.14%
ASIC to be more than a policeman after the event	1	20.00%	3	17.65%	2	33.33%	6	21.43%
ASIC needs to better apply its resources	1	20.00%	3	17.65%	3	**50.00%**	7	25.00%

Remedies & sanctions proposed by interviewees	***No of responses Melbourne***	***% Melbourne***	***No of responses Sydney***	***% Sydney***	***No of responses Brisbane***	***% Brisbane***	***Total responses***	***Total %***
ASIC needs less reliance on box ticking		0.00%	4	23.53%	4	**66.67%**	8	28.57%
Regulatory model needs to use court intervention less:AAT & Takeovers Panel models better	3	**60.00%**		0.00%		0.00%	3	10.71%
Singapore model - Central Provident Fund	1	20.00%	1	5.88%		0.00%	2	7.14%
Singapore model - Barriers to entry	1	20.00%		0.00%		0.00%	1	3.57%
Reform of remuneration model of research houses and ratings agencies	1	20.00%	1	5.88%		0.00%	2	7.14%
Simplicity in superannuation eg MySuper		0.00%		0.00%	1	16.67%	1	3.57%
US has better approach to bribery		0.00%		0.00%	1	16.67%	1	3.57%
Canadian model: bottom up regulation needed		0.00%	5	29.41%	3	**50.00%**	8	28.57%
Singapore & HK far ahead of Aust in Fintech, harmonisation (UCITS), strategy; politics		0.00%		0.00%	2	33.33%	2	7.14%
Return to Prescribed Interest system not a solution		0.00%	1	5.88%		0.00%	1	3.57%
ATO product rulings misleads investors		0.00%	2	11.76%		0.00%	2	7.14%
School level financial literacy education		0.00%	1	5.88%		0.00%	1	3.57%

Remedies & sanctions proposed by interviewees	*No of responses Melbourne*	*% Melbourne*	*No of responses Sydney*	*% Sydney*	*No of responses Brisbane*	*% Brisbane*	*Total responses*	*Total %*
ASIC and APRA removed from government		0.00%	1	5.88%		0.00%	1	3.57%
Need special purpose financial court		0.00%		0.00%	1	16.67%	1	3.57%
Extend UK SMR to MIS - market conduct + supervision		0.00%		0.00%	1	16.67%	1	3.57%
ASIC should prosecute own cases - not DPP		0.00%		0.00%	1	16.67%	1	3.57%
Senate inquiry into litigation funders		0.00%	1	5.88%		0.00%	1	3.57%
Need last resort compensation scheme		0.00%	1	5.88%		0.00%	1	3.57%
Disclosure needs to focus on underlying assets		0.00%	1	5.88%		0.00%	1	3.57%

Interpretation			
Top Quartile	**% Sample**	**Top Decile**	**% Sample**
Related party transactions	60.71%	Related party transactions	60.71%
Financial regulation in isolation: accretive tinkering: need trust principles	57.14%	Financial regulation in isolation: accretive tinkering: need trust principles	57.14%
Intrusion of 'black' letter law	50.00%	Intrusion of 'black' letter law	50.00%
Conflicts of interest - related trustees & investment managers/promoters/advisers	50.00%	Conflicts of interest - related trustees & investment managers/promoters/advisers	50.00%
Box ticking regulation by ASIC	46.43%	Box ticking regulation by ASIC	46.43%
Financial planning not a profession	46.43%		
Appearances of probity only: self interest rules	39.29%		
Australian financial sector not internationally competitive in structure or fees	35.71%		
Ineffective leadership at ASIC/ wrong leadership motivations	35.71%		
Smart lawyer manipulation of complex 'black letter' law	32.14%		
Financial planners should have unqualified best interest duty to client	32.14%		
Boards need more independent minds	32.14%		
Adviser financial literacy often flawed	32.14%		
Most favoured reform options			
All to be subject to fiduciary principles	50.00%		

APPENDIX 2: CORRELATION MATRICES: TOP DECILE, TOP QUARTILE AND SYSTEMIC FAILURES INCIDENCES

2.1 Legal matters raised in the judgments	Variable	Top decile prevalence	Variables						
		n =343 incidences	1	2	3	4	5	6	7
Related party transactions CA s 191	1	22.16%	1						
Misleading & deceptive/unconscionable conduct CA s 1041H, AA s 12DA, ACCA s 52	2	20.70%	93.42%	1					
Fraud	3	15.45%	69.74%	74.65%	1				
Breach of fiduciary duties (statute & general law) CA s 601FD	4	14.87%	67.11%	71.83%	96.23%	1			
Financial services business CA s 911A/ financial advice CA s 781/ dealing CA s 780 without AFSL	5	13.70%	61.84%	66.20%	88.68%	92.16%	1		
Breach of good faith, proper purpose, best interest duty CA ss 181-184, 961 (FoFA)	6	13.12%	59.21%	63.38%	84.91%	88.24%	95.74%	1	
Conflicts of interest & duty CA s 191	7	13.12%	59.21%	63.38%	84.91%	88.24%	95.74%	100.00%	1

2.2 Legal matters raised in the judgments	Variable	Top quartile prevalence	Variables														
		n = 623 incidencies	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Related party transactions CA s 191	1	12.20%	1														
Misleading & deceptive/unconscionable conduct CA s 1041H, AA s 12DA, ACCA s 52	2	11.40%	93.42%	1													
Fraud	3	8.51%	69.74%	74.65%	1												
Breach of fiduciary duties (statute & general law) CA s 601FD	4	8.19%	67.11%	71.83%	96.23%	1											
Financial services business CA s 911A/ financial advice CA s 781/ dealing CA s 780 without AFSL	5	7.54%	61.84%	66.20%	88.68%	92.16%	1										
Breach of good faith, proper purpose, best interest duty CA ss 181-184, 961 (FoFA)	6	7.22%	59.21%	63.38%	84.91%	88.24%	95.74%	1									
Conflicts of interest & duty CA s 191	7	7.22%	59.21%	63.38%	84.91%	88.24%	95.74%	100.00%	1								
Unregistered unlawful MIS CA s 601ED	8	6.90%	56.58%	60.56%	81.13%	84.31%	91.49%	95.56%	95.56%	1							
Insolvency of NBFE (Incl RE/trustee)	9	5.30%	43.42%	46.48%	62.26%	64.71%	70.21%	73.33%	73.33%	76.74%	1						
Judicial/Court directions	10	5.14%	42.11%	45.07%	60.38%	62.75%	68.09%	71.11%	71.11%	74.42%	96.97%	1					
Failure to properly disclose material matters CA s 191	11	5.14%	42.11%	45.07%	60.38%	62.75%	68.09%	71.11%	71.11%	74.42%	96.97%	100.00%	1				
Untrue/defective/misleading prospectus/PDS disclosure CA s 728	12	4.17%	34.21%	36.62%	49.06%	50.98%	55.32%	57.78%	57.78%	60.47%	78.79%	81.25%	81.25%	1			
Improper financial advice	13	3.85%	31.58%	33.80%	45.28%	47.06%	51.06%	53.33%	53.33%	55.81%	72.73%	75.00%	75.00%	92.31%	1		
Uncommercial/unconscionable transactions	14	3.69%	30.26%	32.39%	43.40%	45.10%	48.94%	51.11%	51.11%	53.49%	69.70%	71.88%	71.88%	88.46%	95.83%	1	
Breach of trustee &/or RE duties (uncategorised)	15	3.53%	28.95%	30.99%	41.51%	43.14%	46.81%	48.89%	48.89%	51.16%	66.67%	68.75%	68.75%	84.62%	91.67%	95.65%	1

2.3 Legal matters raised in the judgments		**By systemic failure**	**Variables**									
		n = 801 incidencies	1	2	3	4	5	6	7	8	9	10
Dishonesty	1	15.98%	1									
Related parties/conflicts of interest CA s 191	2	15.23%	95.31%	1								
Directors/trustee duties CA ss180-184, SISA s 62	3	15.23%	95.31%	100.00%	1							
Disclosure	4	14.86%	92.97%	97.54%	97.54%	1						
Misleading/deceptive/unconscionable conduct CA s 1041H, AA s 12DA,	5	11.74%	73.44%	77.05%	77.05%	78.99%	1					
Fiduciary duty (statute & general law)	6	9.61%	60.16%	63.11%	63.11%	64.71%	81.91%	1				
Financial advice CA ss 780,781,911; Unlicensed/breaches of AFSL	7	8.86%	55.47%	58.20%	58.20%	59.66%	75.53%	92.21%	1			
Unlawful unregistered MIS CA 601ED	8	5.37%	33.59%	35.25%	35.25%	36.13%	45.74%	55.84%	60.56%	1		
Governance	9	2.75%	17.19%	18.03%	18.03%	18.49%	23.40%	28.57%	30.99%	51.16%	1	
Financial literacy	10	2.12%	13.28%	13.93%	13.93%	14.29%	18.09%	22.08%	23.94%	39.53%	77.27%	1

APPENDIX 3: CHAPTER 3 SOURCES OF AUTHORITY

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